

**UNDERSTANDING THE POLITICAL ECONOMY OF  
SUCCESSFUL STATE-OWNED ENTERPRISE MANAGEMENT:  
A CASE STUDY OF THE PANAMA CANAL AUTHORITY**

by  
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**Dissertation Abstract:**

The Panama Canal turnover was not expected to end well. As the U.S. Senate deliberated upon the Panama Canal treaties in 1977, opponents painted a grim portrait of the canal's future under Panamanian control. They warned of a toxic combination of Panamanian incompetence, malfeasance and greed. A common argument portrayed Panama as a politically unstable tropical backwater. To make matters worse, the threat of Soviet domination loomed. How could a poor country of 3.6 million people operate and maintain a complicated and internationally vital waterway? Very well, it turned out.

This dissertation evaluates how Panama exceeded the alarmingly low expectations of its critics. In doing so, it details and analyzes the doomsday projections regarding the December 31, 1999 Panama Canal turnover. The research situates those concerns in the context of academic literature on state-owned enterprise management, and questions whether such profound skepticism was warranted in the case of Panama. To evaluate Panama's performance operating the canal, the dissertation reviews a range of published material, including independent analyses of Panama's canal management, as well as internal evaluations. It also provides independent qualitative and quantitative reviews of Panama's record, including comparisons to the U.S. canal administration, interviews, a survey by the author of executives at multinational shipping companies, and a Panama national public opinion poll by the author.

The dissertation adopts a case study approach and relies upon process tracing and thick description to determine the factors that contributed to Panama's successful canal management. The analytic narrative is not chronological. It begins with a general discussion of state-owned enterprises; evaluates Panama's canal management; explores

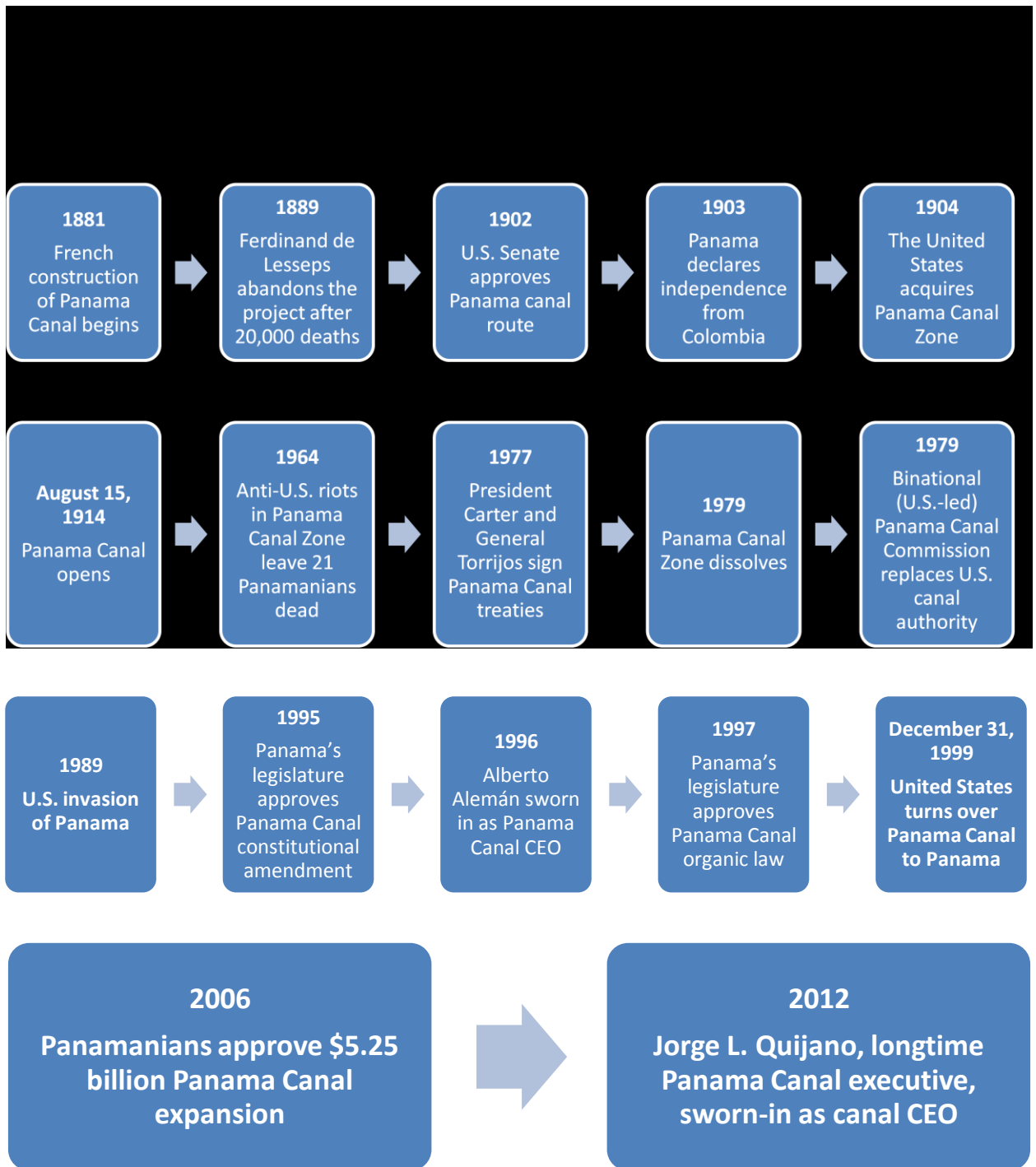
the roots of Panama's success; explains why predictions of Panama's performance proved wildly inaccurate; and identifies risks to the Panama Canal Authority's continued efficiency. The dissertation concludes by highlighting potential best practices for other countries operating consequential state-owned enterprises.

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## **Chapter 1: Introduction: Objectives and methods**

### **Overview**

The Panama Canal turnover was expected to go badly. Throughout the negotiations over the turnover treaties, and especially during the U.S. Senate debates in 1977, opponents painted a grim portrait of the canal's future. The two treaties passed by only a single vote.<sup>1</sup> A decade into the phased transition to Panamanian ownership, scholars and the U.S. public still remained deeply skeptical.<sup>2</sup> How could a poor country of 3.6 million inhabitants operate and maintain a complex and internationally vital waterway that the United States had run since its opening in 1914? Very well, it turned out. In the 2012 fiscal year, the canal set a tonnage record.<sup>3</sup> Since the United States ceded control, accidents are way down.<sup>4</sup> Revenue, profits and traffic are way up. A \$5.25 billion expansion is doubling capacity. Panama's economy expanded by 10.7 percent in 2012, three times the regional average,<sup>5</sup> and has continued to grow at an impressive rate. The canal accounts for 22 percent of Panama's GDP.<sup>6</sup>

This dissertation evaluates how Panama exceeded the alarmingly low expectations of its critics. It reviews the doomsday predictions for the December 31, 1999 canal turnover; the two decade transition to Panamanian ownership; and the first 15 years of Panamanian management. These developments are discussed in the global context of

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<sup>1</sup> The Senate passed both treaties by a vote of 68 to 32, one vote above the two-thirds threshold.

<sup>2</sup> A CBS News poll in May 1989 found that 26 percent of respondents believed the United States should not comply with its treaty obligation to transfer the canal to Panama.

<sup>3</sup> Panama Canal Authority, Annual Report, 2012, p. 13.

<sup>4</sup> Interview by author with Miguel F. Rodríguez, manager of canal operations, August 15, 2013, Panama City, Panama.

<sup>5</sup> Panama's 2012 GDP from the International Monetary Fund's "Regional Economic Outlook, Western Hemisphere," May 2013; regional GDP from the United Nations's "World Economic Situation and Prospects," December 2013.

<sup>6</sup> International Monetary Fund, Article IV consultation for Panama, 2012.

state-owned enterprises, which are commonly characterized by patronage, debt and incompetence.<sup>7</sup> Building upon the literature on public administration, organizational behavior, corruption and state-building, the research sets out to offer a richly detailed and nuanced case study that advances state-owned enterprise theory and extrapolates lessons for state-owned enterprises worldwide. (More broadly, insights into state-owned enterprise management should contribute to the wider debate over the proper role and size of government, and whether a developmental state is a sufficient condition for growth,<sup>8</sup> an impediment, or something in between.)

To evaluate Panama's success, the research relies in part upon semi-structured interviews with Panamanian and U.S. actors who played central roles in the treaty negotiations; the transition to Panamanian ownership; and Panama's canal management. Interview participants include three former Panamanian presidents – Martín Torrijos (2004 to 2009), Nicolás Barletta (1984 to 1985) and Aristides Royo (1978 to 1982) – former Panama Canal CEO Alberto Alemán (1996 to 2012), former U.S. Secretary of State James Baker (1989 to 1992) and former U.S. President Jimmy Carter (1977 to 1981). To complement these and other elite perspectives, the research involves a national public opinion poll in Panama, and a survey of global shipping executives who have used the canal under U.S. and Panamanian management. Historical research includes archival reviews of newspapers in the United States, Panama and the former Panama Canal Zone;<sup>9</sup> transcripts of U.S. Senate hearings; memoirs; and documents in the Jimmy Carter Library

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<sup>7</sup> Arief Budiman, Diaan-Yi Lin and Seelan Singham, "Improving Performance at State-Owned Enterprises," McKinsey & Company, May 2009.

<sup>8</sup> Meredith Woo-Cummings (editor), *The Developmental State* (Ithaca, N.Y.: Cornell University Press, 1999).

<sup>9</sup> For example, *The Panama Star*, founded in 1849, circulated widely in the former Panama Canal Zone and provides a window into the views of U.S. citizens living in Panama regarding the treaties and the transition to Panamanian control.

and Museum and at the Biblioteca Roberto F. Chiari (the Panama Canal library in Panama City, Panama), and the National Archives and Library of Congress. For quantitative analysis, the research reviews historical data to compare the performances of U.S. and Panamanian canal authorities on a variety of metrics; a discussion of the significance of Panamanian management (a binary independent variable) on these performance metrics relative to exogenous independent variables, such as trends in global trade and economic growth in regions that rely upon the canal. Finally, to convey the complexities of canal administration, and enrich the narrative of the dissertation, the research incorporates direct observation of canal operations, including a ride-along aboard a Panamax cargo ship transiting the canal, and a tour of the canal expansion site.<sup>10</sup>

The relevance of the dissertation is magnified by the absence of similar studies,<sup>11</sup> and by the timing of the completion of this research, just as Panama completes its historic canal expansion. That development will focus global attention on Panama's performance managing the waterway, and raise questions about the Panama Canal Authority's record that this research attempts to address.

At the same time, the research contributes to the theoretical understanding of state-owned enterprise governance. These policy-relevant lessons apply equally to economically influential firms such as national oil and mining companies and to smaller operations that cumulatively represent substantial contingent liabilities for national governments. The legitimacy and solvency of countless governments depends upon a firmer understanding of this issue. State-owned enterprises are ubiquitous. In parts of

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<sup>10</sup> The ride-along, on August 18, 2013, involved a full, 12-hour canal transit aboard the NYK Meteor container ship, which travels from Busan, China, to New York City, N.Y.; the tour of the canal expansion was led by Panama Canal Authority engineer Luis Ferreira on August 23, 2013.

<sup>11</sup> Scholars have largely overlooked this period in the otherwise carefully chronicled history of the canal.



Africa, they account for half of economic activity; in parts of Asia, Eastern Europe and Latin America, they control as much as 15 percent of the economy.<sup>12</sup> Some are profitable, such as the Corporación Nacional del Cobre de Chile (CODELCO), the world's largest copper producer.<sup>13</sup> Others, however, drain government resources and represent a contingent liability (implicit and explicit) that threatens to bankrupt the central government. The challenge of effectively managing state-owned enterprises is as relevant to micro states such as Grenada – where there are 29, including a gravel concern<sup>14</sup> – as it is to China – where there are 20,000, including banks whose politically motivated, countercyclical lending threatens a financial crisis.<sup>15</sup> In Latin America, Panama's success is contrasted most notably by the national oil companies in Mexico and Venezuela, whose payrolls are larded with unqualified political appointees and whose revenues are ravenously siphoned by central authorities rather than reinvested. Other examples, inside and outside the hemisphere, abound. (Chapter 2 provides a fuller history of state-owned enterprises and the most common management and oversight challenges. Chapter 6 discusses the recent scandal at Brazil's national oil company Petróleo Brasileiro.)

## **Research Problem**

The basic question motivating and structuring this research is how Panama succeeded in effectively managing the Panama Canal in the face of low expectations and high obstacles.

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<sup>12</sup> Budiman 2009, p. 1.

<sup>13</sup> Profit in 2012 equaled \$7.5 million, according to CODELCO's annual report, <http://www.codelco.com/memoria2012/site/edic/base/port/inicio.html>.

<sup>14</sup> International Monetary Fund, Article IV consultation for Grenada, 2012.

<sup>15</sup> Simon Rabinovitch, "China Banks' Bad Loans Point to Trouble Ahead," *The Financial Times*, October 30, 2013.

President Jimmy Carter's negotiations over the Panama Canal turnover provoked deep anxiety. The U.S. government had controlled the canal since it opened in 1914, linking the Atlantic and Pacific oceans. Republicans, including influential U.S. Senators Jesse Helms (R-N.C.) and Strom Thurmond (R-S.C.), led a national campaign against the handover. These and other opponents argued that the planned turnover jeopardized U.S. national security by threatening to deny U.S. merchants and Navy vessels access to the 50-mile long waterway. Critics warned of skyrocketing tolls; an end to first-come, first-served queuing; and the replacement of technocrats in the canal administration with corrupt and blundering Panamanian political appointees. Skeptics questioned the capacity of a small, developing nation with a history of corruption, political instability and authoritarian government to manage a complex, strategically important piece of global infrastructure.

The job requirements included not only operating the canal, but also repairing vessels; managing ports; running the Panama Canal Zone railroad, prisons and zoo; and maintaining roadways and power, communications and water systems.<sup>16</sup> The loudest criticisms originated in the Panama Canal Zone; "Zonians," the U.S. citizens who claimed the most intimate knowledge of Panama's incapacities,<sup>17</sup> insisted Panama was "too backward to run the canal."<sup>18</sup> (The influence of the Zonians is discussed in Chapter 5.) Panamanians themselves were concerned; a political cartoon at the time showed one of Panama City's wildly painted city buses, known as *diablos rojos*, or "red devils,"

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<sup>16</sup> Denison Kitchel, *The Truth about the Panama Canal*. New Rochelle, N.Y.: Arlington House, 1978, p. 133.

<sup>17</sup> John P. Augelli, "The Panama Canal Treaties of 1977: Impact and Challenges," *Yearbook: Conference of Latin Americanist Geographers*, Vol. 11 (1985), p. 75.

<sup>18</sup> Adam Clymer, *Drawing the Line at the Big Ditch: The Panama Canal Treaties and the Rise of the Right* (Lawrence, Kan.: University Press of Kansas, 2008), p. 4.

floating through the locks.<sup>19</sup> In the United States, a “truth squad” toured the country and sent millions of letters and raised millions of dollars to fight the treaties.<sup>20</sup> It did not help that Panama was governed by the strongman Omar Torrijos, an “antagonistic and unstable” dictator, in the words of Ronald Reagan, whose opposition to the turnover served as the centerpiece of his 1968 campaign for the Republican presidential nomination.<sup>21</sup> These anxieties nearly sunk the treaties.

For their part, advocates stressed the canal’s vulnerability to sabotage by disillusioned Panamanians, and the regional and global opposition to continued U.S. control. (In 1973, the United Nations Security Council met in Panama to address the issue,<sup>22</sup> and the resulting resolution, vetoed by the United States, would have prohibited states from any measures “to coerce another state in order to obtain from it the subordination of the exercise of its sovereign rights.”<sup>23</sup>) Ultimately, U.S. Senate debate on the Panama Canal treaties dragged on for six weeks, the longest treaty battle since deliberations over the Treaty of Versailles.<sup>24</sup> In the end, the treaties achieved the required two-thirds majority by a single vote, 68 to 32.

Fears over the turnover persisted. Over time, the rhetoric moderated from the late 1970s, when Rep. Philip Crane (R-Ill.), in *Surrender in Panama: The Case Against the Treaty*, had condemned Panama as an “impoverished tropical backwater,”<sup>25</sup> a “poverty-

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<sup>19</sup> Interview by author with Ricaurte Vásquez, former canal chief financial officer, August 2, 2013, Panama City, Panama.

<sup>20</sup> Michael J. Hogan, *The Panama Canal in American Politics: Domestic Advocacy and the Evolution of Policy* (Carbondale, Ill.: Southern Illinois University Press, 1986), p. 7.

<sup>21</sup> Clymer 2008, p. 21.

<sup>22</sup> Thomas M. Leonard, *Panama, the Canal and the United States: A Guide to Issues and References* (Claremont, Calif.: Regina Books, 1993), p. 89.

<sup>23</sup> United Nations Security Council Resolution 330, March 21, 1973.

<sup>24</sup> Hogan 1986, p. 7.

<sup>25</sup> Philip Crane, *Surrender in Panama: The Case Against the Treaty* (New York City, N.Y.: Dale Books, 1978), p. 6.

stricken, pestilential province”<sup>26</sup> and a “backward banana republic”<sup>27</sup> that had no hope of effectively managing the canal. Still, anxiety lingered. In his 1998 book, *Panama’s Canal: What Happens When the United States Gives a Small Country What It Wants*, Mark Falcoff lamented the venal political culture and “historic patterns of public administration” in Panama, where “Panamanians of all classes have regarded government agencies as so much booty to be distributed among followers of the ruling party.”<sup>28</sup> A decade after the treaties were signed, the Panama Canal again seized U.S. public attention during the December 20, 1989 U.S. invasion of Panama. “Operation Just Cause” had various causes, including criminal indictments in Florida against Panamanian President Manuel Noriega for cocaine trafficking. Undoubtedly, however, the future of the canal factored into President George H.W. Bush’s decision. Noriega, who governed Panama after Torrijos’s 1981 death in a plane crash, had “systematically violated the American-Panamanian canal treaties.”<sup>29</sup> In justifying the invasion to Congress, Bush said a continuation of Noriega’s rule would mean “the continued safe operation of the Panama Canal and the integrity of the canal treaties would be in serious jeopardy.”<sup>30</sup> Later, in the months before the 1999 Panama Canal turnover, the U.S. public again turned its eyes to the canal. Once more, observers registered their objections. Up to the moment of the turnover, Robert McMillan, a former chairman of the Panama Canal Commission,

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<sup>26</sup> Ibid, p. 4.

<sup>27</sup> Ibid, p. 103.

<sup>28</sup> Mark Falcoff, *Panama’s Canal: What Happens When the United States Gives a Small Country What It Wants* (Washington, D.C.: AEI Press, 1998), p. 59.

<sup>29</sup> Gilboa, Eytan, “The Panama Invasion Revisited: Lessons for the Use of Force in the Post Cold War Era,” *Political Science Quarterly*, Vol. 4 (1995), p. 539.

<sup>30</sup> George H.W. Bush, letter to Speaker of the House of Representatives Thomas S. Foley, December 21, 1989.

remained “very apprehensive about how efficiently Panama would run the canal.”<sup>31</sup>

President Bill Clinton, Vice President Al Gore and Clinton’s secretary of state, Madeleine Albright, declined to attend the historic turnover ceremony.

On December 31, 1999, the canal finally changed hands. Fifteen years later, it is clear the hysteria was unjustified. By all measures, Panama is living up to its responsibilities. It has invested mightily in canal modernization and safety.<sup>32</sup> Usage and revenue are up, with over 14,000 vessels from more than 100 countries transiting annually. In the 2012 fiscal year, the canal set a record, facilitating transit of 333.7 million tons of cargo.<sup>33</sup> Accidents are rare. Closures are unheard of. As feared, tolls are up significantly. Those increases, however, have not diverted ships around Cape Horn and sent the canal into “bankruptcy and closure.”<sup>34</sup> In perhaps the clearest sign of Panama’s unexpected achievement, Panama is completing a \$5.25 billion canal expansion. The project involves deepening the Pacific and Atlantic canal entrances; widening and deepening the navigational channels leading to Gatún Lake; deepening the Culebra Cut; and installing two new sets of locks – “PostPanamax” ship elevators 40 percent longer and 60 percent wider than the original locks – to add a third lane of transit and permit passage by larger vessels. The project is doubling canal capacity.<sup>35</sup> Before the Panama Canal Authority approached lenders to finance the expansion, Moody’s Investors Service assigned the authority an A2 rating.

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<sup>31</sup> Robert R. McMillan, *Global Passage: Transformation of Panama and the Panama Canal* (Charleston, S.C.: BookSurge Publishing, 2009), preface.

<sup>32</sup> Amber Moss, “What benefits Do You See the Expansion Project Bringing Panama?”, *Latin America Advisor*, April 27, 2006.

<sup>33</sup> Panama Canal Authority, Annual Report, 2012.

<sup>34</sup> Philip M. Crane, *Surrender in Panama: The Case Against the Treaty* (New York City, N.Y.: Dale Books, 1978), p. 13.

<sup>35</sup> Whitefield, Mimi, “Panama Canal’s \$5 Billion Makeover Could be Boon for South Florida,” *The Miami Herald*, November 17, 2012.

Panama, of course, could still stumble. However, sufficient time has passed to judge, and learn from, Panama's performance. Outside observers have noted that the canal authority "enjoys an exceptionally strong operating position," having "successfully navigated the transition from U.S. management."<sup>36</sup> In Panama, the public expressed a powerful vote of confidence in 2006, when a national referendum on the authority's ambitious expansion project attracted the backing of 80 percent of voters.

This dissertation examines how Panama sidestepped the political and administrative catastrophes that so many analysts and U.S. lawmakers predicted. To address that question, it tests the hypothesis that Panama's success is largely attributable to the sophisticated institutional design of the Panama Canal Authority, in particular its robust autonomy from the central government, and the narrow scope of its mission. Of special interest is the intellectual development of the authority's unique structure, and the social and political processes involved in the drafting and passage of the legislation and constitutional amendment that established the authority. These reforms set up the authority's 11-member board, with members serving staggered nine-year terms and authorized to write their own budget, with the national legislature permitted only an up or down vote. The constitutional amendment requires profitability,<sup>37</sup> and eschews the conflicting mandates that bog down so many state-owned enterprises.<sup>38</sup> At the same time, the dissertation is not methodologically handcuffed by institutionalism. The research also examines the historical, political and sociological factors that have prevented a single amendment to the Panama Canal constitutional article and legislation, and led Panama's

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<sup>36</sup> Hu, Chee Mee, "Moody's Assigns a Prospective (P) A2 Rating to the Senior Unsecured Debt Obligations of the Panama Canal Authority in Conjunction with the Expansion Project," Moody's Investors Service, September 10, 2008.

<sup>37</sup> Constitution of Panama, Title XIV, Article 316.

<sup>38</sup> Budiman 2009, p. 1.

political class to honor the authority's independence in practice. This part of the analysis includes a review of the legacy of U.S. canal administration, and the extraordinary role the United Nations Development Program played in post-war Panama, where it organized a series of national dialogues on the future of the Panama Canal. That there remains in this dissertation a strong focus on institutional design results from a review of the literature on state-owned enterprises, and the observation that in most respects other than the Panama Canal Authority's design, Panama shares characteristics with developing countries in which state-owned enterprises have struggled mightily.

To test this hypothesis, the research considers the significance of other independent variables affecting Panama's performance, such as the infrastructure, personnel, policies and norms inherited from the United States; the lengthy, phased transition to Panamanian control; the threat of international intervention continuously disciplining Panama and canal authorities; global trade trends; and the leadership of the first Panamanian canal administrators. These alternative explanations for Panama's success undoubtedly help explain Panama's performance. (For example, in the most recent scholarly treatment of the canal, Noel Maurer and Carlos Yu noted that the two-decade transition to Panamanian control meant the canal "entered the twenty-first century better managed than ever before in its history."<sup>39</sup>) However, this research demonstrates that exogenous factors played relatively minor roles in determining Panama's performance. True, the canal was in tip-top shape at the time of the turnover.<sup>40</sup> However, that was largely because Panamanian canal officials had demanded a pre-turnover audit

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<sup>39</sup> Noel Maurer and Carlos Yu, *The Big Ditch: How America Took, Built, Ran and Ultimately Gave Away the Panama Canal* (Princeton, N.J.: Princeton University Press, 2010).

<sup>40</sup> Interview by author with Peter Romero, former U.S. assistant secretary of state, July 18, 2013, Washington, D.C.

by the U.S. Army Corps of Engineers that led to a \$1 billion modernization.<sup>41</sup> True, the lengthy, phased transfer permitted Panama to acquire needed human capital. The transition, however, was also plagued by racism against Panamanian canal officials and notoriously poor bilateral coordination.<sup>42</sup>

## Literature Review

There is no shortage of academic literature and popular historical writing on the Panama Canal. After all, Europeans began dreaming of a transisthmian shortcut as far back as the 16th century. Historians exhaustively documented canal construction, beginning with the 1881 arrival of French engineers who sought unsuccessfully to replicate the sea-level design they used at Suez (e.g., David McCullough's 1978 *The Path Between the Seas: The Creation of the Panama Canal, 1870 – 1914*, covering the French and U.S. undertakings). The canal is also an object of fascination for, *inter alia*, maritime historians, engineers and medical historians (who are interested in the advances in knowledge of mosquito-borne illnesses, such as yellow fever and malaria, during canal construction).<sup>43</sup> Journalistic works (e.g., Adam Clymer's 2008 *Drawing the Line at the Big Ditch: The Panama Canal Treaties and the Rise of the Right*) mostly focus on the impacts of the canal debate on U.S. domestic politics. However, nowhere in this ocean of literature is there a contemporary, comprehensive evaluation of the political economy of Panama's canal management. After the turnover failed to produce political and

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<sup>41</sup> Alemán, Alberto, "The Story That Panama Decided to Write, The Panama Canal Through the Years," *ReVista*, Spring 2013.

<sup>42</sup> Ana Elena Porras, *Historias Canaleras: Doce Testimonios de la Transición* (Panama City, Panama: Universidad de Panamá, Instituto de Estudios Nacionales, 2007), p. 75.

<sup>43</sup> For example, John M. Barry, *The Great Influenza: The Story of the Deadliest Pandemic in History* (New York City, N.Y.: Viking, 2004).



administrative failures, journalistic and scholarly attention turned elsewhere. There have been no serious attempts to make sense of Panama's success, refine state-owned management theory accordingly and identify relevant policy lessons for state-owned enterprise management.

## **Research Plan**

To explain Panama's performance, the dissertation relies upon a multi-method, historical case study approach that involves qualitative and quantitative techniques. To justify the selection of the case, the research focuses intensively on Panama's canal administration to demonstrate its success relative to the U.S. government's performance prior to the turnover,<sup>44</sup> and compared to other state-owned enterprises worldwide. Relevant data includes quantitative performance metrics (e.g., revenue, profit, speed of transit, accidents and availability of critical Panama Canal equipment) contained in independent audits of the Panama Canal Authority, the authority's annual reports and its internal evaluations. Annual reports from the authority's immediate predecessors – the U.S. government's Panama Canal Company, and the U.S.-led, binational Panama Canal Commission that oversaw the canal during the transition – permit comparative analyses. To obtain the perceptions of important stakeholders, the research involves a survey of executives at global shipping firms that have utilized the canal under U.S. and Panamanian management. The research accesses this group, in coordination with major industry associations, through a poll that addresses satisfaction with the Panama Canal Authority, perceptions of its transparency and related topics. To encourage candor,

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<sup>44</sup> Given that the U.S. government administered the canal as a non-profit operation, comparisons of financial performance will be approached with caution.

interviews are conducted anonymously and data is examined in the aggregate (i.e., not on an individual basis).

Given that the hypothesis relates to the Panama Canal Authority's institutional design, the research pays particular attention to the authority's legal relationship to Panama's central government; its hiring and procurement practices; and its internal affairs capabilities. These characteristics are considered in the context of other Panamanian government institutions and in comparison to state-owned enterprises globally. Because this dissertation is also concerned with how these structures came about in Panama, and how they survived on paper and in practice, the research follows the process tracing method. This method – though somewhat limiting in terms of the external validity of findings – is well suited to explaining outcomes that result from a multitude of interacting, independent variables.<sup>45</sup> In this case, these variables include the intellectual origins of the authority's design; the political learning of Panamanian elites following the traumatic Noriega years and the 1989 U.S. invasion of Panama; factors that engendered elite support and popular backing for the Panama Canal Authority's independent structure<sup>46</sup>; and conditions that permitted the effective implementation and maintenance of the authority's autonomy. Absent the causal explanations that process tracing generates, the research would be at risk of excessive formalism, i.e., it would potentially place undue emphasis on legalistic factors at the expense of important intervening variables, such as the social and political processes that permitted the establishment and maintenance of the legal attributes correlated with successful

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<sup>45</sup> Alexander L. George and Andrew Bennett, *Case Studies and Theory Development in the Social Sciences* (Cambridge, Mass.: MIT Press, 2005), p. 206.

<sup>46</sup> Gerardo L. Munck, "The Past and Present of Comparative Politics," in Gerardo L. Munck and Richard Snyder, eds., *Passion, Craft and Method in Comparative Politics*. Baltimore, Md.: The Johns Hopkins University Press, 2007.

management. Additionally, process tracing permits an accessible presentation of the case that involves narrative and analytical elements.<sup>47</sup>

In terms of data collection, as discussed, the research relies upon in-depth, semi-structured interviews with current and former Panama Canal officials and influential active and retired Panamanian policymakers, union leaders and others. This method plays to the strengths of the author, a Spanish-speaking, experienced interviewer and former reporter for *The Boston Globe*. These interviews have several aims including: identifying the intellectual authors of the Panama Canal Authority's design; determining how Panama achieved elite and social consensus, with the help of United Nations Development Program-led civil society dialogues; and explaining how Panama avoided the biggest threat to successful canal administration – mismanagement through chaotic and predatory rent-seeking and the politicization of the Panama Canal Authority. Other key informants interviewed include former U.S. officials involved in the treaty negotiations – including former President Jimmy Carter – and individuals involved in the U.S. canal administration and the transition to Panamanian control. The research also includes a public opinion survey conducted by the author of a representative sample of the Panamanian population (1,228 respondents, aged 18+, living in Panama, covering the entire national territory) to understand public opinion as it relates to the canal. Finally, to represent and contextualize the objections to the turnover, the research reviews the positions of protagonists in the protracted debate over the Panama Canal treaties, such as former U.S. Sen. Bob Dole (R-Kan.) and conservative activist Richard Viguerie, whose tireless opposition to the treaties involved novel campaign tools. The data obtained from

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<sup>47</sup> Andrew Abbott, *Methods of Discovery: Heuristics for the Social Sciences* (New York City, N.Y.: W.W. Norton & Co., 2004), p. 175.

the interviews and surveys complement documentary sources – such as memoirs,<sup>48</sup> newspaper archives, Senate hearing transcripts and declassified U.S. government documents – related to U.S. canal management, the transition to Panamanian control, and Panamanian canal management. In selecting these sources, the dissertation considers their historical and historiographical contexts;<sup>49</sup> for example, it evaluates whether a writer or speaker was agitating for or against the canal treaties in the United States or Panama.<sup>50</sup> The fieldwork includes two trips to Panama City, Panama, and research at the Johns Hopkins University libraries, the Library of Congress, the National Archives, and the Jimmy Carter Library and Museum.

Given the varied nature of the qualitative data in the dissertation – including reviews of primary source materials, academic literature, interviews, and technical performance metrics – diverse analytical methods are employed. The advantages of methodological pluralism are well documented.<sup>51</sup> For this research, qualitative data is viewed from perspectives that include, *inter alia*, the perceptions of elite actors; theory on collective social action and social organization; and Panamanian political culture as it relates to public corruption, transparency, and the separation of powers. In all cases, the analysis distinguishes between the actual actions of individuals, institutions and social groups and their descriptions of their roles and relative influence as revealed in interviews, memoirs and through other first-person accounts.

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<sup>48</sup> For example, U.S. canal treaties negotiator Sol M. Linowitz's *The Making of a Public Man: A Memoir* (New York City, N.Y.: Little, Brown, 1985).

<sup>49</sup> Martha C. Howell and Walter Prevenier, *From Reliable Sources: An Introduction to Historical Methods* (Ithaca, N.Y.: Cornell University Press, 2001), p. 19.

<sup>50</sup> Although Panama was governed by an authoritarian regime at the time, the canal treaties were subject to a national referendum.

<sup>51</sup> Norman K. Denzin and Yvonna S. Lincoln, *Collecting and Interpreting Qualitative Materials* (Thousand Oaks, Calif.: Sage Publications, 2008), p. 288.

As discussed, there are potential challenges to the external validity of the observational, n=1 design.<sup>52</sup> That said, in this Panama Canal case study, the change in national ownership effectively presents two cases of Panama Canal institutional design and management; stated generically, there are multiple observations on the dependent variable. Furthermore, each of the 100 years of canal management generated data that is used for comparative purposes in this dissertation. Still, the Panama Canal case does have its share of *sui generis* characteristics, which somewhat limit the universality of research conclusions. These include, as mentioned, the Panama Canal's high international profile, with the implication that the threat of international intervention motivates good behavior. (Though the idea of another invasion is farfetched, the issue is nontrivial, given memories in Panama of the 1989 U.S. invasion.) The dissertation is also cognizant of potentially problematic antecedent variables,<sup>53</sup> such as Panama's inheritance from the United States of functioning canal infrastructure (e.g., locks, locomotives and tug boats), as well as U.S. policies and norms (e.g., merit-based hiring and competitive bidding) that are otherwise uncommon in Panama. Taken together, these elements suggest a potential path dependency that the dissertation acknowledges and addresses. Panama's decades of confrontation with the United States over ownership of the canal – a conflict central to Panama's modern history – also sets apart the experience of this particular state-owned enterprise from the broader universe of government-run corporations.

Additional challenges to the dissertation's efforts to extract conclusions that can be generalized relate to the nature of the canal business. As a natural monopoly, its

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<sup>52</sup> William M. Trochim, *The Research Methods Knowledge Base*, <http://www.socialresearchmethods.net/kb/>, 2006.

<sup>53</sup> Stephen Van Evera, *Guide to Methods for Students of Political Science* (Ithaca, N.Y.: Cornell University Press, 1997), p. 53.

competitors are less obvious than for other state-owned enterprises. Additionally, the Panama Canal's infrastructure is nonstandard as compared to an electric utility or railroad. Finally, the administrators of the Panama Canal do not experience political pressure to maintain low prices, since the Panamanian public is not an important customer – a key difference from the standard state-owned enterprise. Many state-owned enterprises, such as national oil companies, face statutory mandates or political pressure to subsidize domestic consumption and other state-owned enterprises at great fiscal expense. In Brazil, for example, the national oil company, *Petróleo Brasileiro* (Petrobras), sells imported fuel at a loss to limit inflation and social unrest.

Moreover, the dissertation accepts that “there are no globally valid rules for organizational design,” and thus “the field of public administration is necessarily more of an art than a science.”<sup>54</sup> As with any human endeavor, the social, political and legal context are relevant to the management of any particular state-owned enterprises, and are “embedded in ever-changing institutional and cultural configurations.”<sup>55</sup> Therefore, any theory related to state-owned enterprise design and administration should carry the standard caveat, “depending on circumstances and some exceptions.”<sup>56</sup> That is to say, the best practices for the Panama Canal Authority are not necessarily identical to those for the Tennessee Valley Authority, let alone a state-owned Chinese bank or coal plant.

Nevertheless, there are strong arguments for this research design, and for using the Panama Canal case study to identify best practices from the Panamanian experience

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<sup>54</sup> Francis Fukuyama, *State-building: Governance and World Order in the 21st Century* (Ithaca, N.Y.: Cornell University Press, 2004).

<sup>55</sup> Dietrich Rueschemeyer, *Usable Theory: Analytic Tools for Social and Political Research Source* (Princeton, N.J.: Princeton University Press, 2009), p. 6.

<sup>56</sup> Charles E. Lindblom, *Inquiry and Change: The Troubled Attempt to Understand and Shape Society* (New Haven, Conn.: Yale University Press, 1990), p. 139.

and advance the theoretical understanding of state-owned enterprises and related theories on public administration, corruption, “islands of excellence” and state-building. Notwithstanding advances in quantitative methods and data management tools, many broadly applicable theories are initially based on a particular case.<sup>57</sup> Moreover, the dissertation’s methodological approach is particularly well suited for Panama, which exhibits characteristics normally considered perilous for state-owned enterprises: public corruption, poor governance, poverty, inequality, populism and limited rule of law. Furthermore, Panama’s particularistic characteristics do not substantially limit the external validity of the conclusions of the Panama Canal case study. For example, as with the Panama Canal, Venezuela’s state-owned oil company, *Petróleos de Venezuela* (PDVSA), is profoundly important to the Venezuelan national economy, yet PDVSA’s chronic mismanagement challenges a simplistic “golden goose” explanation for Panama’s success. In Mexico, the 1938 nationalization of oil resources is celebrated as a national holiday and is arguably as culturally significant to Mexicans as the recuperation of the Panama Canal was to Panamanians. Yet unlike Panama, Mexico underinvested in *Petróleos Mexicanos* (Pemex), leading to chronically declining production. Contrary to the conventional wisdom, the Panama Canal, like other state-owned enterprises, does face competition, from alternative shipping routes such as the Suez Canal and from the intermodal (ships, trucks and trains across the United States) alternative to reaching the U.S. East Coast from East Asia. Finally, the Panama Canal Authority might have been born with a leg up on other state-owned enterprises, but it could have easily squandered that advantage by jettisoning U.S. management practices and destroying its infrastructure

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<sup>57</sup> Stéphane Dufour, Jacques Hamel and Dominic Fortin, *Case Study Methods* (Newbury Park, Calif.: Sage Publications, 1993), p. 35.

through misuse and poor maintenance. In this context, an understanding of the origins of Panama's success should be of interest to theorists and practitioners.



## **Chapter 2: State-owned enterprises: A historical perspective**

### **Introduction**

Panama skeptics had plenty of ammunition against President Jimmy Carter's proposed canal turnover. There were, after all, ample arguments regarding the country's chaotic politics, poor governance and disinterest in maintenance, not to mention crude stereotypes about Latin America. But for some critics, the singularly unimpressive record of government-run businesses was reason enough to forecast catastrophe for the canal in Panamanian hands. Historically, state-owned enterprises had struggled even in wealthy societies. Panama was to be especially treacherous ground. Poverty, income inequality and underdevelopment would provide a powerful temptation for public officials to divert resources from the canal for social spending.<sup>58</sup> Widespread public corruption, meanwhile, raised the prospect of the relentless looting of canal assets and patronage in canal hiring.<sup>59</sup>

### **State-Owned Enterprises**

State-owned enterprises did not always have such a bad rap. Scholarly and public opinion on this subject has evolved over the past five centuries. In some eras, state-owned enterprises were credited with driving national prosperity. For example, in the thick of the "Brazilian miracle" – presided over by a technocratic military dictatorship (1964 to 1985) – one observer concluded that "sustained economic development requires more than following the dictates of the international market and getting prices right; indeed it

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<sup>58</sup> In 2010, 13.8 percent of Panamanians lived on less than \$2 per day and the wealthiest 10 percent accounted for 40.1 percent of total income, according to the World Bank's World Development Indicators.

<sup>59</sup> Transparency International ranked Panama 102 out of 177 countries and territories evaluated in its 2013 Corruption Perceptions Index. The organization regards scores below 50 as an indication of a "serious corruption problem"; Panama earned a 35.

may on occasion involve rejecting such signals.”<sup>60</sup> At other times, economists dismissed state-owned enterprises as unaffordable state overreach. Their critique of “state bloat”<sup>61</sup> applied most of all to developing countries like Panama, guilty of a stark imbalance between what Francis Fukuyama calls state “scope” and state “strength.” In other words, it referred to institutionally weak governments playing an outsized role in economic management.

Regardless of the prevailing scholarly opinion, governments have been trying their hand at business for ages. In the seventeenth century, the United Kingdom, France, Spain, Portugal and the Netherlands established multinational trading companies that operated for the following two centuries.<sup>62</sup> Government ties furnished tremendous authority and perks, including subsidies; exemptions from customs dues; the use of government ships; ownership of foreign lands; and even the power to sign treaties, hire soldiers<sup>63</sup> and build forts. The policy motivation was mercantilist; governments sought wealth and influence by regulating commerce, imposing tariffs on imports and operating trading companies to guarantee a positive balance of trade.<sup>64</sup> Protectionism alone was not considered sufficient to deliver a trade surplus, so governments promoted manufacturing and exporting.<sup>65</sup>

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<sup>60</sup> Albert Fishlow, “Brazilian Development in Long-Term Perspective,” *The American Economic Review* Vol. 70, No. 2 (1980): p. 102.

<sup>61</sup> Francis Fukuyama, *State-Building: Governance and World Order in the 21st Century* (Ithaca, N.Y.: Cornell University Press, 2004), p. 4.

<sup>62</sup> Ellison, Julian. “State Enterprise.” In *International Encyclopedia of the Social Sciences*, edited by William A. Darity Jr. Vol. 8, 2nd ed. Detroit: Macmillan Reference USA, 2008, p. 106.

<sup>63</sup> Coornaert, E.L.J. “European Economic Institutions and the New World: The Chartered Companies.” In *The Cambridge Economic History of Europe*, edited by E.E. Rich and C.H. Wilson. Vol. 4, 2nd ed. Cambridge, United Kingdom: Cambridge University Press, p. 248.

<sup>64</sup> A positive balance of trade – or trade surplus – signifies that export earnings exceed import costs.

<sup>65</sup> Magnusson, Lars. “Mercantilism.” In *International Encyclopedia of the Social Sciences*. Edited by William A. Darity Jr. Vol. 5, 2nd ed. Detroit: Macmillan Reference USA, 2008, p. 93.

The popularity of mercantilism – or at least state encouragement of exports – has waxed and waned since the days of the Dutch East India Company (1602 to 1799). But state-owned enterprises have never totally gone out of style. In the nineteenth century, Prussia’s Otto von Bismarck funded his government by running railroads, mines, factories and farms.<sup>66</sup> His successors followed his lead. In 1926, the German government established Lufthansa as its national carrier. A decade later, in 1937, Adolf Hitler founded Volkswagen to manufacture an affordable automobile. (During World War Two, he directed its factory to churn out warplanes, bazookas and bombs.) Later, European governments catching up with the industrialized United Kingdom also embraced the “entrepreneurial state.” In the Soviet Union, of course, virtually all commercial enterprises belonged to the state. But in France, too, the authorities operated railroads, airlines and electric utilities for centuries. State-owned enterprises – publically owned entities that derive their revenue not from taxation but from the sale of goods and services – have known few geographical or ideological boundaries.

The establishment of state-owned enterprises – and the nationalization of those born in private hands – has occurred for a variety of reasons, including:

1. Ideology, such as skepticism about the productive efficiency and social equity of markets;
2. Social policy goals, such as increased employment;
3. Economic development objectives, such as the search for countercyclical fiscal policy tools; the desire to prevent the exploitation of natural monopolies; and an attempt to “foster modernization in the neglected sections of otherwise developed economies, or stimulate growth in strategic sectors of the economy by initiating public activities”<sup>67</sup>;

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<sup>66</sup> Ellison 2008, p. 106.

<sup>67</sup> Pier Angelo Toninelli, “The Rise and Fall of Public Enterprise,” in *The Rise and Fall of State-Owned Enterprise in the Western World* (Cambridge, United Kingdom: Cambridge University Press, 2000), p. 8.

4. To obtain technical knowledge about the operation of desirable industries;<sup>68</sup>
5. To develop economies of scale in desirable industries;
6. To prevent “wasteful competition,” such as competition that “relied upon misinforming customers, predatory behavior to drive rivals out of business and the cutting of costs by sacrificing reliability and safety”<sup>69</sup>;
7. National security priorities, such as the desire to guarantee supplies of iron, steel, gunpowder and oil;
8. To overcome private sector financing limitations in capital-intensive industries;
9. To permit an “infant industry” to survive its initial production period, during which its costs are higher than those of established foreign competitors<sup>70</sup>; and,
10. To manage the systemic risks of major bankruptcies (with respect to so-called too big to fail firms).

Wading into the subject of state-owned enterprises, it is hard not to tumble into the broader intellectual and political debates over the proper size and role of government. That particular fight has been raging at least since Adam Smith. (Or perhaps even earlier, since Jean-Baptiste Colbert’s writings on industrial policy.) In 1776, in “The Wealth of Nations,” Smith assigned a limited role to government: secure the national defense, assure public security and establish institutions that no private enterprise could operate profitably.<sup>71</sup> That third category is subject to considerable interpretation; for example, it could arguably include public education and even health care. It does not, however, envision government-run airlines. In Smith’s view, state economic management is beside the point. An economic actor who “intends only his own gain” inadvertently acts in ways that strengthen a society’s economic health. Taken together, self-serving economic agents keep resources efficiently deployed and the economy growing. Smith, of course, has

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<sup>68</sup> Paul H. Frankel, *The Rationale of National Oil Companies* (New York City, N.Y.: Pergamon Press, 1980), p. 5.

<sup>69</sup> Christopher D. Foster, *Privatization, Public Ownership and the Regulation of Natural Monopoly* (Oxford, United Kingdom: Blackwell, 1992), p. 72.

<sup>70</sup> Howard Pack and Kamal Saggi, “Is there a Case for Industrial Policy? A Critical Survey,” *The World Bank Research Observer* Vol. 21, No.2. (2006), p. 269.

<sup>71</sup> James A. Caporaso and David P. Levine, *Theories of Political Economy* (New York City, N.Y.: Cambridge University Press, 1992), p. 44.

always had critics. Friedrich List, for one, warned governments not to rely blindly upon comparative advantage based on resource endowments, such as a relatively high number of workers or relative abundance of certain natural resources. Instead, presaging modern industrial policy, he called upon governments to assure that national “*productive powers* are awakened and developed” (italics in original),<sup>72</sup> even if that involves short-term costs. “A nation capable of developing a manufacturing power,” List wrote, “acts quite in the same spirit as that landed proprietor did who by the sacrifice of some material wealth allowed some of his children to learn a productive trade.”<sup>73</sup>

The Smith-List debate was polite compared to 20th century disagreements over a government’s ideal role in economic management. Friedrich Von Hayek, writing during World War Two, considered state economic intervention not merely inefficient, but as a one-way ticket to authoritarianism. Grudgingly, he accepted that “in no system that could be rationally defended would the state just do nothing.”<sup>74</sup> However, he insisted that too much economic control leads to too little civil liberty. Government economic control, Hayek argued, requires disregarding individual preferences, and so attracts to office individuals (“the ruthless and unscrupulous”<sup>75</sup>) who are attracted to dictatorial powers. You could tell by the title of his book – “*The Road to Serfdom*” (1944) – that he did not take the subject lightly. “Once you admit that the individual is merely a means to serve the ends of the higher entity called society or the nation, most of those features of totalitarian regimes which horrify us follow of necessity.”<sup>76</sup> Karl Polanyi, writing in the same era, was decidedly less suspicious of government. He rejected a society whose

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<sup>72</sup> Friedrich List, *The National System of Political Economy* (New York City, N.Y.: A.M. Kelley, 1885).

<sup>73</sup> Ibid.

<sup>74</sup> Friedrich Von Hayek, *The Road to Serfdom* (Chicago, Ill.: University of Chicago Press, 1944), p. 39.

<sup>75</sup> Ibid., p. 151.

<sup>76</sup> Ibid., p. 149.

economy was governed by the free market's "invisible hand," as popularized by Smith. "Such an organization of economic life is entirely unnatural," Polanyi wrote in 1944, pointing to income inequality and poverty and advocating the "discarding of market utopia."<sup>77</sup>

This debate, of course, has never been settled. Recent iterations focused on disagreements over the proper sequencing of economic and political liberalization in authoritarian societies. Some scholars argued that democratization promoted economic liberalization and economic growth through the establishment of the rule of law – one of Smith's preconditions for a functioning market. Others wielded empirical data to demonstrate that growing economies tended to sustain democratic government whereas democratizing, economically underdeveloped countries often saw democratic institutions stumble as new civil liberties permitted destabilizing demands for income redistribution.<sup>78</sup> Today, debates over economic intervention and industrial policy often focus on the effectiveness of Keynesian policies, or on the rejection of the Washington Consensus and the inconclusive search for a new guiding philosophy. There is somewhat less of a push for the pure laissez-faire framework, and somewhat more of a push for the argument, advanced by José Antonio Ocampo in his 2006 paper "Market, Social Cohesion and Democracy," that "the economic system must be subordinated to broader social objectives." Still, important works continue to be published on both sides of the divide, including Howard Pack and Kamal Saggi's "The Case for Industrial Policy," also published in 2006, and research by Dani Rodrik, Ricardo Hausmann and Justin Lin. Fortunately, these controversies need not be settled in an effort to trace the history of

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<sup>77</sup> Karl Polanyi, *The Great Transformation* (New York City, N.Y.: Farrar & Rinehart, 1944), p. 267.

<sup>78</sup> Barry Eichengreen, *Globalizing Capital* (Princeton, N.J.: 2008, Princeton University Press, 2008), p. 6.

state-owned enterprises, evaluate their effectiveness and desirability, and extract lessons from Panama's experience.

### **Golden Age**

The heyday for state-owned enterprises began in the interwar period, as the Great Depression brought capitalism into disrepute.<sup>79</sup><sup>80</sup> Reformers saw state-owned enterprises as an antidote to a variety of supposed market failures, and as a counterweight to excessively powerful corporations. This was as true in defeated Germany – which restructured its financial system – as it was in the victorious United Kingdom, which partially nationalized British Petroleum and established the British Broadcasting Corporation in 1922.<sup>81</sup> Italy nationalized its railroads. The Netherlands established a salt company. Government rescues of failing firms fueled the trend. In the 1970s, for example, the British government governed Rolls Royce and Jaguar. Canada created the Canadian National Railways, after World War I, to prevent a disruptive bankruptcy.<sup>82</sup> (During the Great Recession that began in 2008, a similar motivation led the United States to establish the Troubled Asset Relief Program and purchase a 61 percent stake in General Motors<sup>83</sup> and a 92 percent stake in the American International Group, the world's largest insurer at the time.<sup>84</sup>) In general, the Japanese government refrained from running

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<sup>79</sup> Toninelli 2000, p. 4.

<sup>80</sup> In Latin America, there are state-owned enterprises that predate the Great Depression, as shown by Robert Devlin et al. in a 2004 paper on publically owned corporations and privatization.

<sup>81</sup> Today, the British Broadcasting Company, known as the BBC, has 60 million customers, \$8.4 billion in annual revenue and is among the most powerful media companies in the United Kingdom.

<sup>82</sup> Peter Catterall. "Nationalization." In *International Encyclopedia of the Social Sciences*. Edited by William A. Darity Jr. Vol. 5, 2nd ed. Detroit: Macmillan Reference USA, 2008, p. 419.

<sup>83</sup> U.S. Department of the Treasury, *GM Timeline*, 2013, Washington, D.C., <http://www.treasury.gov/press-center/press-releases/Documents/GM%20Timeline.pdf>.

<sup>84</sup> U.S. Department of the Treasury, *Treasury Receives Payment From Its Final Sale of AIG Common Stock, Bringing Positive Return on Overall AIG Commitment to \$22.7 Billion*, Press Release, December 14, 2012, <http://www.treasury.gov/press-center/press-releases/Pages/tg1805.aspx>.

businesses. Similarly, the United States generally preferred regulation to direct participation in private sector affairs. That said, the U.S. government operated a national postal service and parceled out public land to promote residential development and subsidize the transcontinental railroad and land-grant colleges.<sup>85</sup> While the United States was relatively anti-statist (President Calvin Coolidge (1923 to 1929) famously remarked that “the chief business of the American people is business”), city governments operated water systems, wastewater treatment plants, electric utilities and hospitals.

By the early 1980s, state-owned enterprises were generating a quarter of manufacturing output in many industrialized countries and an even higher percentage in poorer regions.<sup>86</sup> No longer were governments only focused on non-rivalrous, non-excludable goods – such as clean air, the national defense or the rule of law – that are universally accessible and whose use by one individual does not diminish the quantity available to others. Even the broader category of public goods – such as education – no longer marked the limit of a typical state’s reach. Public employees worldwide were suddenly growing tobacco, mixing cement and assembling airplanes. The level of autonomy of these enterprises varied greatly. In the United Kingdom, government ministers had to fight for influence over the independent boards of directors that operated state-owned enterprises. (The ministerial interest in greater oversight authority was natural, given the scrutiny by parliament, culminating in 1957 with the establishment of a

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<sup>85</sup> Louis Galambos, “State-Owned Enterprises in a Hostile Environment, The U.S. Experience,” in *The Rise and Fall of State-Owned Enterprise in the Western World* (Cambridge, United Kingdom: Cambridge University Press, 2000), p. 280.

<sup>86</sup> Toninelli 2000, p. 9.



legislative committee to oversee nationalized industries.<sup>87)</sup> By contrast, economic losses, in the United Kingdom and elsewhere, motivated relatively high levels of government involvement in the daily management of railroads, coal mines and other industries. The pursuit of social goals – such as maintaining low inflation by controlling prices – further increased the role of the state in state-owned enterprise management.

### **Petering Out**

The state-owned enterprise trend began to peter out in the 1970s, undone by the clumsy performance of most state-owned enterprises, such as airlines and telecommunications firms. Their financial results were by and large “abysmal,” and in many countries, their operation was believed to have a “pernicious effect on the economy as a whole.”<sup>88</sup> State-owned enterprises, never skilled at making money, had reward structures favoring ever growing expenditures, with a manager’s prestige measured by the number of his or her subordinates.<sup>89</sup> In Poland, state-owned enterprise losses equaled 9 percent of GDP in 1989.<sup>90</sup> In Pakistan, the return on capital for state-owned enterprises averaged just 2 percent in the 1970s and 4 percent in the early 1980s, compared to an average rate of inflation of 12 percent.<sup>91</sup> In Brazil, in the late 1970s, the rate of return on equity for state-owned enterprises was one-half the return earned by the private sector. Not surprisingly, privatization quickly became a fashionable policy option.

Changes in ownership structure of state-owned enterprises came about in radically different circumstances, but these transitions had in common a clear preference for

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<sup>87</sup> Foster 1992, p. 80.

<sup>88</sup> Yair Aharoni, “The Performance of State-Owned Enterprises,” in *The Rise and Fall of State-Owned Enterprise in the Western World* (Cambridge, United Kingdom: Cambridge University Press, 2000), p. 49.

<sup>89</sup> Anthony Downs, *Inside Bureaucracy* (New York City, N.Y.: Little, Brown, 1993), p. 264.

<sup>90</sup> *Ibid.*, p. 54.

<sup>91</sup> Mahmood A. Ayub and Sven O. Hegstad, “Management of Public Industrial Enterprises,” *The World Bank Research Observer* Vol. 2, No. 1 (1987): p. 82.

shrinking government. Over all, between 1988 and 1993, governments privatized 2,655 firms.<sup>92</sup> In Chile in the early 1970s, the military rulers empowered the “Chicago Boys” – Chilean economists trained at the University of Chicago – to implement “El Ladrillo” (“The Brick”), an orthodox adjustment strategy that reversed the reforms of deposed socialist President Salvador Allende (1970 to 1973). In addition to drastic expenditure cuts (public spending plummeted from 39 percent of GDP in 1974 to 23 percent in 1981), the strategy involved massive privatizations, beginning with banks.<sup>93</sup> A similar process occurred throughout South America’s Southern Cone (comprising the countries of Argentina, Chile, Paraguay and Uruguay). Gradually, governments rejected economic strategies originally conceived during the Great Depression, such as high tariffs and the promotion of government as a producer and entrepreneur that could compensate for evaporating export markets.<sup>94</sup> In Prime Minister Margaret Thatcher’s United Kingdom (1979 to 1990), a divestiture drive squeezed state-owned enterprise activity to 1.9 percent of GDP in 1991 from 6.1 percent in 1978.<sup>95</sup> Between 1974 and 1980, Chile sold 130 state-owned enterprises, with a value of more than \$500 million.”<sup>96</sup> In the former Soviet Union, only several thousand state-owned enterprises remain. In China, the total has dropped from hundreds of thousands to as few as 20,000.<sup>97</sup> (Those that remain are not always best in class. State-owned banks, for example, engage in questionable lending that

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<sup>92</sup> Nicola Bellini, “The Decline of State-Owned Enterprise and the New Foundations of the State-Industry Relationship,” in *The Rise and Fall of State-Owned Enterprise in the Western World* (Cambridge, United Kingdom: Cambridge University Press, 2000), p. 26.

<sup>93</sup> Francisco E. González, *Dual Transitions from Authoritarian Rule: Institutionalized Regimes in Chile and Mexico* (Baltimore, Md.: Johns Hopkins University Press, 2008), p. 38.

<sup>94</sup> Joseph Ramos, *Neoliberal Economics in the Southern Cone of Latin America, 1974-1983* (Baltimore, Md.: Johns Hopkins University Press, 1986), p. 8.

<sup>95</sup> Bellini 2000, p. 27.

<sup>96</sup> Mary M. Shirley, “Managing State-Owned Enterprises,” in *World Development Report* (Washington, D.C.: World Bank, 1983), p. 85.

<sup>97</sup> Blanding, Michael, “What Capitalists Should Know about State-Owned Enterprises,” *Forbes*, February 22, 2013.

has raised the prospect of widespread defaults that could imperil China's financial system.<sup>98</sup>) In 2014, Cuba, still governed by the Marxist Castro brothers, authorized state-owned enterprises to retain up to 50 percent of their profits, up from 30 percent. The United Kingdom has begun requiring local governments to invite private sector bids for basic government services, with government departments permitted to compete, a practice also used in Australia and New Zealand.

In the historiography of this subject, the arguments are sometimes exaggerated. Points of view as often as not reflect fundamental biases about the proper role of government, with combatants presented “a choice between the principle that production management should be private, unless specific circumstances prevail under which public management is called for, and the principle that production management should be public, unless special circumstances prevail under which private management is called for.”<sup>99</sup> To some degree, state-owned enterprises were caught in the cross-fire of a general assault on economic intervention. If government should stay out of economic management, in other words, it most certainly should not be running businesses. A newly popular argument held that “even when it appears that government action would actually be effective, there is something of a presumption in favor of policies and programs requiring a minimum of administrative and bureaucratic input. This is both because policies, once in place, appear to have a life of their own, and because they divert scarce

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<sup>98</sup> Rabinovitch, Simon, “China Banks’ Bad Loans Point to Trouble Ahead,” *Financial Times*, October 30, 2013.

<sup>99</sup> Richard A. Musgrave, *The Theory of Public Finance: A Study in Public Economy* (New York City, N.Y.: McGraw-Hill, 1959), p. 46.

administrative resources from those in which governmental comparative advantage is stronger.”<sup>100</sup>

As the tide turned against industrial policy, state-owned enterprises earned special consideration. Starting in the mid-1980s, the International Monetary Fund (IMF), the World Bank, multilateral development banks and the U.S. government played an important role in urging indebted countries to rein in their public sectors. Champions of this view – known as the Washington Consensus – held state-owned enterprises in especially low regard. The World Bank’s 1983 World Development Report singled out state-owned enterprises as a chronic source of fiscal strain. It characterized them as jobs programs, whose overmanning hurt employee morale and brought about “disturbing” financial outcomes. Examining a sample of 27 developing countries, World Bank economists found that transfers to state-owned enterprises averaged more than 3 percent of GDP. The World Bank’s findings were a broadside against the very idea of a state-owned enterprise (SOE): “Efficiency is highest when an enterprise strives to maximize profits in a competitive market, under managers with the autonomy, motivation and capability to respond to the challenge of competition. Inefficient enterprises would not be able to compete and would go bankrupt. But SOEs seldom face such conditions.”<sup>101</sup> The World Bank acknowledged that efficiency was theoretically attainable by government-run businesses. But its overall advice was clear: sell them for cash, to save on subsidies and above all, because “private industry is managed more efficiently than state

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<sup>100</sup> Anne O. Krueger, “Governmental Failures in Development,” in *Modern Political Economy and Latin America: Theory and Policy*, ed. Jeffrey Frieden (Boulder, Colo.: Westview Press, 2000), p. 16.

<sup>101</sup> Shirley 1983, p. 74.

enterprises.”<sup>102</sup> The World Bank report concluded: “A strong case can be made for letting an enterprise operate on commercial, profit-seeking lines, and then using its profits to achieve social goals.”<sup>103</sup>

According to the neoliberal arguments of the Washington Consensus, not even Bismarckian efficiency could match the effectiveness of private sector incentives, with managers motivated by a share of the profits, or at least answerable to profit seeking owners. The other private sector advantage was counterintuitive: drop the bottomless state support so the threat of bankruptcy could focus a manager’s mind. By this point, economists had generally accepted that “the mark of a capitalistic society is that resources are owned and allocated by such *nongovernmental* organizations as firms, households and markets”<sup>104</sup> (emphasis added). Thanks in part to the collapse of the Soviet Union, in 1991, the neoliberal extensions of that argument increasingly took hold among academics, elites and policymakers worldwide. This occurred even in countries such as Argentina, which since the 1930s had based its development model on industrialization through nationalization and an abiding hostility toward foreign ownership.<sup>105</sup> The new mantra for reform: “Stabilize, deregulate, open up and privatize.”<sup>106</sup> Empirical evidence backed up the shifting public opinion. Ghana’s Cocoa Marketing Board exemplified the self-destructive conflicts inherent to the state-owned enterprise model. The board, established in 1947, was called upon simultaneously to protect farmer incomes; prevent

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<sup>102</sup> John Williamson, ed. *Latin American Adjustment: How Much Has Happened?* (Washington, D.C.: Institute for International Economics, 1990).

<sup>103</sup> Shirley 1983, p. 77.

<sup>104</sup> Armen A. Alchian and Harold Demsetz, “Production, Information Costs and Economic Organization,” *The American Economic Review* Vol. 62, No. 5: p. 777.

<sup>105</sup> David Rock, *Authoritarian Argentina: The Nationalist Movement, its History and its Impact* (Berkeley, Calif.: University of California Press, 1993).

<sup>106</sup> Wade, Robert H. “Washington Consensus.” In *International Encyclopedia of the Social Sciences*, edited by William A. Darity Jr. Vol. 9, 2nd ed. Detroit: Macmillan Reference USA, 2008, p. 38.

scarcity; avoid high consumer prices; and generate tax revenue. In the end, it favored its revenue role. Over time, its imposition of stratospheric export taxes discouraged production; export volumes fell by 80 percent as farmers switched to maize, rice and other crops.<sup>107</sup> Meanwhile, state-owned enterprises that actually turned a profit often came to regret it. Earnings quickly passed into the central government's hands, both through high taxes and embezzlement. That pattern incentivized careless spending and excessive personnel costs. At the same time, comparative studies added weight to the argument that private actors generally outperform their public counterparts running airlines, hospitals, electric utilities and garbage collection.<sup>108</sup> This was also demonstrated in the industrial sector,<sup>109</sup> a prime target for policymakers with a taste for business. Worse yet, the sputtering state-owned enterprises not only wasted public financial resources, but they often failed to provide needed goods and services. Soon, scholars were predicting that the decline of state-owned enterprises was "irreversible."<sup>110</sup>

"Most remarkable of all has been the radical change in the opinion of both the public and elites toward the role of the state in the economy. This change has played a fundamental role in the development of the neoliberal consensus that has dominated economic policy since the 1980s. Part of this consensus has included a belief in the structural inability of SOEs to avoid distorting political interference, and consequently in the long-term superiority of private businesses, no matter how great the efforts made to improve public-sector efficiency."<sup>111</sup>

In this climate, policymakers who refused to loosen their grip on the economy were seen as self-serving, disinclined to reduce their power to distribute government jobs.

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<sup>107</sup> Shirley 1983, p. 77.

<sup>108</sup> James T. Bennett and Manuel H. Johnson, "Public versus Private Provision of Collective Goods and Services: Garbage Collection Revisited," *Public Choice* Vol. 34, No. 1 (1979): p. 55.

<sup>109</sup> Anthony E. Boardman and Aidan R. Vining, "Ownership and Performance in Competitive Environments: A Comparison of the Performance of Private, Mixed and State-Owned Enterprises," *Journal of Law and Economics* Vol. 32, No. 1 (1989): p. 26.

<sup>110</sup> Toninelli 2000, p. 22.

<sup>111</sup> Bellini 2000, p. 27.

In countries that did not experience broad liquidations and privatizations of state-owned enterprises, economists also complained of collective action obstacles that blocked the spontaneous emergence of a protest movement demanding better governance. The public's difficulty evaluating public sector worker performance – particularly in poor countries with low education levels<sup>112</sup> – also reduced the demand for reform. Meanwhile, general public disengagement – as close to a law of nature as political science has yet produced – liberated party leaders to focus on their “internal constituency,”<sup>113</sup> in other words, party insiders and supporters. Similar phenomena explained the rarity of related good governance reforms such as meritocratic recruitment and promotion; competitive salaries for civil servants to reduce the temptation of corruption; the creation of anticorruption agencies; the imposition and implementation of clear anticorruption rules; and open bidding for contracts,<sup>114</sup> or the establishment of an independent procurement authority.<sup>115</sup> Conflicting views on the role of the state in economic management were no longer taken seriously. So in cases where civil society was not stepping up, the IMF quickly mobilized. Through its famous conditionality, its loan requirements led to privatizations throughout the developing world.

In some policy circles, the elimination of state-owned enterprises was seen as a solution to any and all economic troubles. This time around, the arguments were as varied as the motivations had been for the earlier wave of nationalization, such as efforts to:

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<sup>112</sup> Lawrence Jones, Kuno Schedler and Riccardo Mussari, “Assessment of Public Management Reform and Strategy,” in *Research in Public Policy Analysis and Management*, eds. Lawrence Jones, Kuno Schedler and Riccardo Mussari (Bradford, United Kingdom: Emerald Group Publishing Limited, 2004).

<sup>113</sup> Harold Demsetz, “Amenity Potential, Indivisibilities and Political Competition,” in *Perspectives on Positive Political Economy*, eds. James E. Alt and Kenneth A. Shepsle (Cambridge, United Kingdom: Cambridge University Press, 1990).

<sup>114</sup> Barbara Geddes, *Politician's Dilemma: Building State Capacity in Latin America* (Berkeley, Calif.: University of California Press, 1996), p. 42.

<sup>115</sup> Susan Rose-Ackerman, *Corruption and Government: Causes, Consequences and Reform* (Cambridge, United Kingdom: Cambridge University Press, 1999), p. 65.

1. Balance budgets by cutting off subsidies to state-owned enterprises;
2. Improve overall economic performance through increased opportunities for private enterprise;
3. Reduce inflation by curtailing state expenditures and the monetization of deficits;
4. Increase innovation through “debureaucratization”<sup>116</sup>;
5. Respond to pressure from countries whose private sector firms preferred not to compete with coddled, state-owned enterprises; and,
6. Reduce opportunities for public and private corruption or rent-seeking.

## Crude Management

State-owned enterprises in the extractive industries have been so problematic that their failures spawned an entire academic literature that argues that countries would be actually better off without oil or precious metals underfoot. Resource-rich countries such as Nigeria, Zambia, Sierra Leone, Angola and Saudi Arabia grow more slowly than resource-poor countries such as South Korea, Taiwan, Hong Kong and Singapore.<sup>117</sup> True, there are exceptions, such as oil-rich Canada, Norway and Australia, and diamond-rich Botswana.<sup>118</sup> The economically mighty United States was the world’s top mineral producer in the late 19th and early 20th centuries.<sup>119</sup> It is also important to point out that many problems associated with extractive industries are unrelated to the management of the designated state-owned enterprises. For example, a large oil sector, whether privately or publicly controlled, vacuums up labor and capital and thereby shrinks a country’s manufacturing and agricultural sectors. At the same time, “Dutch disease” causes a country’s currency to appreciate, further squeezing export operations, and stifles

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<sup>116</sup> Foster 1992, p. 155.

<sup>117</sup> Halvor Mehlum, Karl Moene and Ragnar Torvik, “Institutions and the Resource Curse,” *The Economic Journal* Vol. 116, No. 508 (2006): p. 1.

<sup>118</sup> Thad Dunning, *Crude Democracy: Natural Resource Wealth and Political Regimes* (Cambridge, United Kingdom: Cambridge University Press, 2008), p. 2.

<sup>119</sup> Daniel Lederman and William F. Maloney, “Neither Curse nor Destiny: Introduction to Natural Resources and Development,” in *Natural Resources, Neither Curse nor Destiny*, ed. William F. Maloney and Daniel Lederman (Washington, D.C.: World Bank Publications, 2007), p. 7.



productive and export diversification, which is essential for growth and development.<sup>120121</sup> Nor should state-owned enterprises be blamed for the misspending of the government revenues they produce, even when those earnings finance the appallingly repressive tactics of leaders such as the late Saddam Hussein of Iraq and the late Muammar el-Qaddafi of Libya. Petro states, where state-owned enterprises are arguably the worst of all, are 50 percent more likely to be ruled by authoritarians.<sup>122</sup> However, the oil money that permits the quashing of opposition could presumably come just as easily from taxing Chevron as from running oil rigs in-house. Similarly, state-owned enterprises can do little about the economically destabilizing volatility of global commodity prices.

In general, however, state-owned enterprises in the extractive industries have been justifiably blamed for retarding economic development and poisoning the political culture. The lack of transparency at these entities permits almost cartoonish levels of theft. Oil revenues, for example, are routinely stolen by public officials. Stolen, that is, on a grand scale. At these state-owned enterprises, the necessary “tight coupling” of accountability and sanctions is unraveled both by government complicity and by opaque revenues and spending.<sup>123</sup> Oil-rich, dirt-poor Nigeria is an evergreen example of the resulting “voracity effects.”<sup>124</sup> In February 2014, Nigeria’s optimistically named president, Goodluck Jonathan, fired the central bank governor, Lamido Sanusi, after

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<sup>120</sup> Jean Imbs and Romain Wacziarg, “Stages of Diversification,” *The American Economic Review* Vol. 93, No. 1 (2003).

<sup>121</sup> Daniel Lederman and William F. Maloney, “R&D and Development,” *World Bank Policy Research Working Paper* (2003).

<sup>122</sup> Michael L. Ross, *The Oil Curse: How Petroleum Wealth Shapes the Development of Nations* (Princeton, N.J.: Princeton University Press, 2012), p. 2.

<sup>123</sup> Andreas Schedler, “Conceptualizing Accountability,” in *The Self-Restraining State: Power and Accountability in New Democracies*, eds. Andreas Schedler, Larry Diamond and Marc F. Plattner (Boulder, Colo.: Lynne Rienner, 1999), p. 7.

<sup>124</sup> Claudio Bravo-Ortega and José de Gregorio, “The Relative Richness of the Poor? Natural Resources, Human Capital and Economic Growth,” in *Natural Resources, Neither Curse nor Destiny*, ed. William F. Maloney and Daniel Lederman (Washington, D.C.: World Bank Publications, 2007), p. 72.

Sanusi blew the whistle on the state-owned Nigerian National Petroleum Corporation for failing to transfer \$50 billion in revenue over an 18-month period.<sup>125</sup> In addition to monumental thievery, state-owned enterprises in the oil business are also vulnerable to influence by political parties. In Mexico, the state-owned oil company Petróleos Mexicanos, known as Pemex, allegedly funneled \$100 million to Institutional Revolutionary Party (PRI) candidate Francisco Labastida's failed 2000 presidential campaign. Nor was that the first time Pemex apparently diverted public funds for partisan use; critics say the PRI treated Pemex as its "own piggy bank" throughout the PRI's six decades of uninterrupted power.<sup>126</sup> Sadly, Pemex's behavior was typical for Latin America, where scarce public funds often serve partisan ends.<sup>127</sup> In Chile, for example, President Salvador Allende doled out management positions at the national copper company using a quota system that rewarded political parties in his leftist coalition based on their relative vote totals in the previous election.<sup>128</sup> Wealthy countries are hardly immune. In France, the oil company Elf Aquitaine has also channeled funds to political parties. In 2003, the authorities prosecuted 37 individuals for involvement in that scandal, including several former ministers.<sup>129</sup> The Italian oil and gas firm Eni has been subject to similar accusations. Like the theft of funds, the diversion of resources for political

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<sup>125</sup> Nossiter, Adam, "Governor of Nigeria's Central Bank Is Fired After Warning of Missing Oil Revenue," *The New York Times*, February 20, 2014.

<sup>126</sup> Schroeder, Jana, "The Pemex-PRI Affair: Oil, Politics and Scandal in Mexico," *World Press Review*, February 21, 2002.

<sup>127</sup> Barry Ames, *Political Survival: Politicians and Public Policy in Latin America* (Berkeley, Calif.: University of California Press, 1987), p. 11.

<sup>128</sup> Geddes 1996, p. 17.

<sup>129</sup> John R. Heilbrunn, "Oil and Water? Elite Politicians and Corruption in France," *Comparative Politics* Vol. 37, No. 3 (2005), p. 277.

purposes hurts state-owned enterprise performance by raising operating costs and lowering efficiency, while eroding public confidence in public institutions.<sup>130</sup>

These forms of “systemic corruption”<sup>131</sup> at state-owned oil companies have another pernicious impact: capital-intensive firms are forced to borrow heavily. This was particularly true in the 1970s, when global commodity prices were high and oil reserves served as attractive collateral for loans.<sup>132</sup> Despite sky-high oil prices, demands on the public purse in oil-producing countries outpaced increases in revenue, leading to cycles of fiscal deficits and heavy borrowing in international capital markets.<sup>133</sup> Excess global liquidity, fueled by petrodollars from the Middle East, also contributed. Those funds found their way to Latin America, where grandiose public works projects and run-of-the-mill skimming vacuumed up new oil revenues quicker than they could accumulate in the public treasury. By the 1980s, Venezuela, despite holding the world’s second-highest proved oil reserves,<sup>134</sup> had borrowed so heavily that it paid foreign banks \$0.40 of every dollar it earned from oil sales.<sup>135</sup> “The boom swelled the aspirations of policymakers, raised expectations and instantly exacerbated the rent-seeking behavior of actors accustomed to the distributive habits of the past.”<sup>136</sup> In this political environment, tax

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<sup>130</sup> Donatella Della Porta and Alberto Vanucci, “The ‘Perverse Effects’ of Political Corruption,” *Political Studies* Vol. 16 (1997).

<sup>131</sup> J. Peter Euben, “Corruption,” in *Political Innovation and Conceptual Change*, ed. Terence Ball, James Farr and Russell L. Hanson (Cambridge, United Kingdom: Cambridge University Press, 1989), p. 242.

<sup>132</sup> Ozmel Manzano and Roberto Rigobón, “Resource Curse or Debt Overhang?,” in *Natural Resources, Neither Curse nor Destiny*, eds. William F. Maloney and Daniel Lederman (Washington, D.C.: World Bank Publications, 2007), p. 44.

<sup>133</sup> Stephan Haggard and Robert Kaufman, “The Politics of Stabilization and Structural Adjustment,” in *Developing Country Debt and the World Economy*, ed. Jeffrey D. Sachs (Chicago, Ill.: University of Chicago Press, 1989), p. 266.

<sup>134</sup> Venezuela had 211.3 billion barrels in proved oil reserves in 2012, according to the U.S. Energy Information Administration.

<sup>135</sup> Terry Lynn Karl, *The Paradox of Plenty: Oil Booms and Petro-States* (Berkeley, Calif.: University of California Press, 1997 ), p. 173.

<sup>136</sup> *Ibid.*, p. 118.

reforms are a tough sell, even in the face of unsustainable fiscal imbalances. It is also difficult to promote economic diversification. As discussed, the high demand for one natural resource leads to an appreciating currency that renders other exports less competitive (the so-called “Dutch Disease”); a nation’s best and brightest misdirect their talents away from entrepreneurship and toward the competition for government favors and jobs in the country’s leading industry<sup>137</sup>; and the high cost of oil discovery and extraction drains capital from other productive sectors. Consequently, the exaggerated reliance upon a single sector only intensifies.

The natural resource sector is subject to ideological fervor. Sometimes earnestly, often cynically, leaders worldwide have inflamed popular passions to justify their firm grip on extractive industries. In some instances, their arguments revolve around legitimate industrial policy objectives, such as the belief that unless the state controls these sectors, developing economies will “resign themselves to a position of perpetual economic inferiority.”<sup>138</sup> By contrast, assuring state control of the oil sector permits development of related industries. This type of thinking has been, and remains, common. In the 1960s, Iran sought more out of its oil and natural gas than tax revenue and royalties. It promoted industrialization and increased agricultural yields through the local production of fertilizers, petrochemicals and electricity generation.<sup>139</sup> In the 1980s, nationalized oil companies in the Middle East were seen as “engines of change, playing a central role in their industrialization policies.”<sup>140</sup> Today in Bolivia – the “Saudi Arabia of

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<sup>137</sup> Anne O. Krueger, “The Political Economy of the Rent-Seeking Society,” *The American Economic Review* Vol. 64, No. 3 (1974): p. 291.

<sup>138</sup> D.H.N. Alleyne, *Energy Utilization for Economic Development in Developing Countries and the Role of the State Petroleum Enterprises* (New York City, N.Y.: Pergamon Press, 1980), p. 175.

<sup>139</sup> *Ibid.*, p. 183.

<sup>140</sup> Ali Jaidah, *Problems and Prospects of State Petroleum Enterprises in OPEC Countries* (New York City, N.Y.: Pergamon Press, 1980), p. 20.

lithium” – the state is not content to mine the Uyuni salt flats and export the valuable metal. Instead, the marching orders for state miners involve the development of a manufacturing empire to churn out batteries for smart phones and electric cars. Never mind that in impoverished Bolivia, with its low-skilled workforce, relatively unadulterated mineral fuels and lubricants account for more half of all exports by value.<sup>141</sup> State planners are still thinking big. “Bolivia is a country blessed with natural resources, but these have been ransacked by outsiders over the years and Bolivians have been left with peanuts,” José Bustillos, the director of operations at the Corporación Minera de Bolivia, known as COMIBOL, said.<sup>142</sup>

### **Backlash to the Backlash**

The backlash against state-owned enterprises was in some respects unfairly harsh. Most of the metrics used to evaluate state-owned enterprise performance focused narrowly on profits. As discussed at length, however, governments do not establish – or nationalize – these firms with profits in mind. In Shanghai, for example, the government explicitly designated three types of state-owned enterprises, with only one of the categories interested in maximizing profits.<sup>143</sup> (The other two focus on strategic projects or municipal operations.) Additionally, the politicization of state-owned enterprises is not unavoidable. Governments have found various ways to keep their meddling to a minimum. By setting up independent boards of directors, policymakers have to varying

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<sup>141</sup> UN Comtrade, *2012 International Trade Statistics Yearbook, Bolivia*, 2012, New York City, N.Y.: United Nations.

<sup>142</sup> Simeon Tegel, “The Bolivian Dream: Lithium Batteries Included,” *GlobalPost*, March 28, 2013, <http://www.globalpost.com/dispatch/news/regions/americas/bolivia/130321/bolivian-lithium-exports-smartphone-electric-car-battery>.

<sup>143</sup> Orr, Gordon, “Action on SOE reform in Shanghai,” *Greater China*, December 19, 2013.

degrees insulated state-owned enterprises. In France, a system of contracts introduced in the late 1960s frontally addressed conflicts between the financial goals and social objectives imposed on state-owned enterprises. For French railroads, for example, these contracts provided compensation for the requirement to operate unprofitable routes. Other governments have created oversight boards so that government ministries do not engage directly with state-owned enterprise managers. Outside, nonpartisan audits have helped improve accountability. Even in China, which has generally not favored autonomy for state-owned enterprises, publically run companies are not all still seen as “muscle-bound goons.”<sup>144</sup> This is particularly true of Chinese state-owned enterprises that have been partially privatized, such as the computer maker Lenovo, which bought IBM’s personal computer division in 2004. As Chinese government control has lessened, so has government support. From 1994 to 2005, 3,658 Chinese state-owned enterprises failed,<sup>145</sup> and cost-cutting led to tens of millions of layoffs. Examining these and other cases of successful, middle-of-the road reforms, it is clear that absolute autonomy from the government might not be necessary. “Insulation does not mean that government bureaucrats must be surrounded by stone walls and moats”<sup>146</sup>; indeed, as a state-owned enterprise ages, it often develops a self-sustaining esprit de corps that wards off political intervention. In the United States, for example, the civil service has become an influential lobby that agitates against patronage.<sup>147</sup>

Furthermore, in instances where a state-owned enterprise seems distracted from its core business, that is often by design. In Kazakhstan, for example, President Nursultan

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<sup>144</sup> Jonathan Woetzel, *Reassessing China’s State-owned Enterprises* (New York City, N.Y.: McKinsey & Company, 2008).

<sup>145</sup> Ibid.

<sup>146</sup> Geddes 1996, p. 50.

<sup>147</sup> Rose-Ackerman 1999, p. 221.

Nazarbayev sees the public railroad company Temir Zholy, known as K.T.Z., as a potential global leader in railroad manufacturing and an engine of industrialization. At the same time, he treats the company like an employment and social services agency. One in every 54 workers in Kazakhstan is on the K.T.Z. payroll and in some towns, the K.T.Z. stationmaster oversees schools and roads.<sup>148</sup> At times, companies such as K.T.Z. manage to turn a profit. However, that often reflects monopolistic pricing rather than skilled management or a commitment to economic efficiency. After all, even profit maximizing managers find themselves subject to disruptive government interventions in cases where profits are a secondary concern. Policymakers, for example, often set prices for a state-owned enterprise's inputs and outputs. "The state has used SOEs as a policy instrument to achieve all sorts of goals, not only economic development, but also political goals and relief of distribution pressures. SOEs have been required to employ individuals with certain political affiliations or to confer largess on certain interest groups."<sup>149</sup> These and other interventions are not all financially harmful; state-owned enterprises often enjoy cheap capital and direct government subsidies. Either way, the substantial government involvement complicates a simple profitability analysis.

Alternative approaches to measuring state-owned enterprise performance are similarly problematic. "Social audits" – evaluating a firm based on its broader mission – require governments to specify, and ideally quantify, their goals for a firm's "double bottom line." In another challenge, a comparison of a firm's operations with its past performance assumes consistent government intervention. In cases of privatization, a comparison of a firm under both ownership structures must take into account legal

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<sup>148</sup> Bradsher, Keith, "Kazakhstan's Bet on Rail," *The New York Times*, November 20, 2013.

<sup>149</sup> Aharoni 2000, p. 52.

reforms that give private investors the ability to set prices and change staffing and compensation levels, flexibilities that public managers often lacked. Similarly, privatizations tainted by corruption or political favoritism – or that simply establish a privately owned monopoly overseen by a powerful regulatory authority – also frustrate efforts to determine a clear relationship between ownership structure and performance. The tendency of governments to unload the worst performing state-owned enterprise further muddies the water. Finally, comparisons with private sector performance are also difficult because state-owned enterprises are clustered in low-growth industries. (Though plenty of private sector actors have found a way to turn a profit drilling oil and mining gold and iron ore.) The empirical evidence underlines these analytical challenges. In Latin America, privatized infrastructure has generated only modest financial returns, particularly for water and transportation.<sup>150</sup> Further complicating the debate is evidence that within countries, state-owned enterprises themselves vary widely in effectiveness.<sup>151</sup>

The defense of state-owned enterprises does not rely exclusively on challenges to the metrics of success (e.g., profitability) or manner of comparison. It is also bolstered by examples of governments that have given privately owned competitors a run for their money. Brazil's great modernizer, the bespectacled strongman Getúlio Vargas (1930 to 1945, 1951 to 1954), inherited a corrupt, ragtag bureaucracy when he seized power in 1930. Such was the disarray that the Brazilian government could not keep track of its own debts thanks to careless recordkeeping.<sup>152</sup> In response, Vargas established the Administrative Department of Public Service to oversee Brazil's civil service and

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<sup>150</sup> Sophie Sirtaine, Maria Elena Pinglo, J. Luis Guasch and Vivien Foster, "How Profitable Are Infrastructure Concessions in Latin America? Empirical Evidence and Regulatory Implications," *The Quarterly Review of Economics and Finance* Vol. 45, No. 2-3 (2005).

<sup>151</sup> Ayub 1987, p. 79.

<sup>152</sup> Geddes 1996, p. 45.



government procurement. The new agency demonstrated that Brazil's government was not irredeemably venial and incompetent. Gradually, the Administrative Department of Public Service increased its authority, eventually overseeing the national budget. It did not survive Vargas's ouster in a coup d'état. But when Vargas returned to the presidency, he again challenged assumptions about Brazil's public sector. This time, his strategy involved "bolsoes de eficiencia," literally "pockets of efficiency," such as a newly created national development bank, the Banco Nacional de Desenvolvimento Econômico e Social, known as BNDES. Staffed by former officials of the Administrative Department of Public Service, its success convinced Vargas's successor to set up other autonomous entities, including the Fundação Getulio Vargas, a respected research institution and university that, like BNDES, still operates and is considered an "island of excellence" in Brazil. In France, decades before its privatization in 1996, the automaker Renault, at one time the largest car manufacturer in Europe,<sup>153</sup> was widely considered well-run.<sup>154</sup> In India, economic liberalization initially nearly crushed the State Bank of India, which saw its market share nosedive from 35 percent to 15 percent. However, its new chairman, Om Prakash Bhatt, reanimated the bank, which has 200,000 employees across 10,000 branches. In 2008, after two years of growth under Bhatt, it became the largest bank in India in terms of market capitalization.<sup>155</sup> Chief Operating Officer Idris Jala pulled off a similar turnaround at the state-owned Malaysia Airlines, which was all-but bankrupt

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<sup>153</sup> Cohen, M.L. *International Directory of Company Histories*, Vol. 26, s.v. "Renault S.A." Detroit: St. James Press, 1999.

<sup>154</sup> Mancur Olson, "Toward a Unified View of Economics and the Other Social Sciences," in *Perspectives on Positive Political Economy*, eds. James E. Alt and Kenneth A. Shepsle (Cambridge, United Kingdom: Cambridge University Press, 1990), p. 228.

<sup>155</sup> Roger Malone, *Remaking A Government-Owned Giant: An Interview with the Chairman of the State Bank of India, Om Prakash Bhatt Discusses the Transformation of One of India's Oldest Banks and Reveals How He Managed to Bring the Company's 200,000 Employees on Board* (New York City, N.Y.: McKinsey & Company, 2009), p. 50.

when Jala arrived in 2005. The airline had suffered from the standard symptoms of state management, including an obese payroll and costly government mandates, such as requirements to fly unprofitable routes. Taking advantage of the airline's financial crisis, Jala altered flight frequencies, eliminated routes and cut costs, including through the sale of the airline's headquarters in Kuala Lumpur. In 2007, Malaysia Airlines recorded record profits.<sup>156</sup> In general, as governments liberalized formerly closed economies following the "lost decade" of the 1980s, a handful of state-owned enterprises rose to the occasion.

Remarkably, these "islands of excellence" have in some cases vanquished the ultimate state-owned enterprise boogeyman: corruption. Mobutu's Congo and Stroessner's Paraguay are classic, colorful tales of patrimonialism. Of the more pedestrian variety, there is the Mexican police<sup>157</sup> and the Indian civil service.<sup>158</sup> Less known – and sometimes short-lived – are the counterpoints. The powerful anticorruption agencies in Hong Kong and Singapore.<sup>159</sup> Uganda's success in discouraging the theft of school funds by publicizing government grants in local newspapers.<sup>160</sup> Efen Plana's rescue of the Bureau of Internal Revenue, a notorious den of corruption in Ferdinand

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<sup>156</sup> Alex Dichter, *Turning around a Struggling Airline: An Interview with the CEO of Malaysia Airlines, Idris Jala Led the State-Controlled Carrier from the Brink of Bankruptcy to Record-Breaking Profits. Now He Wants it to Become What He Calls a "Five Star Value Carrier."* The airline, of course, later faced financial difficulties following two notorious crashes in 2014, the unexplained disappearance of Flight 370 en route from Kuala Lumpur to Beijing with 239 people on board, and the loss of a second Boeing 777, carrying 298 people, which was shot down over Ukraine.

(New York City, N.Y.: McKinsey & Company, 2008), p. 6.

<sup>157</sup> Nelson Arteaga Botello and Adrian Lopez Rivera, "Everything in this Job is Money: Inside the Mexican Police," *World Policy Journal* Vol. 17, No. 3 (2000).

<sup>158</sup> Marianne Bertrand, Simeon Djankov, Rema Hanna and Sendhil Mullainathan, "Obtaining a Driving License in India: An Experimental Approach to Studying Corruption," *The Quarterly Journal of Economics* Vol. 122, No. 4 (2006).

<sup>159</sup> Patrick Meagher, "Anti-corruption Agencies: Rhetoric versus Reality," *The Journal of Policy Reform* Vol. 8, No. 1 (2005).

<sup>160</sup> Ritva Reinikka and Jakob Svensson, "The Power of Information: Evidence from a Newspaper Campaign to Reduce Capture," *World Bank Policy Research Working Paper* No. 3239 (2004).

Marcos's Philippines, profiled in Robert Klitgaard's influential 1998 book, "Controlling Corruption."<sup>161</sup>

There is no consensus regarding the catalysts for reforms that help establish successful state-owned enterprises, or prevent a prompt reversal of fortune. As with much good government reform, state-owned enterprise improvement often comes about because of a charismatic leader. In other situations, crises help. Corruption scandals, for example, engender public outrage that can force political leaders to act. In the United States, for example, it took the murder of President James Garfield, shot at a Washington, D.C. railway station by a disgruntled jobseeker,<sup>162</sup> to bring about civil service reform.<sup>163</sup>

Helpfully, scholars have identified common elements in the few cases of state-owned enterprise success.<sup>164</sup> They include:

1. The presence of competition, including through an export orientation;
2. Financial autonomy;
3. Managerial autonomy;
4. Clear objectives;
5. Access to capital markets, permitting private investors to provide apolitical scrutiny and guidance;
6. Explicit compensation for the costs of pursuing social objectives, as is common in France, Italy and Sweden;
7. Limits to and centralization of government oversight to avoid "confusion, duplication and excessive control"<sup>165</sup>; and,
8. An independent, merit-based hiring system.

In some circles nowadays, the Washington Consensus has become a bigger punching bag than the long-vilified state-owned enterprises. Neoliberal economists who

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<sup>161</sup> Robert Klitgaard, *Controlling Corruption* (Berkeley, Calif.: University of California, 1998), p. 15.

<sup>162</sup> An enraged jobseeker, Charles Guiteau, shot President Garfield in the back on July 2, 1881, while President Garfield was en route to visit his wife in Elberon, N.J. President Garfield died on September 19, 1881, on the New Jersey shore, after Alexander Graham Bell failed to remove the lodged bullet using an induction-balance electrical device he invented.

<sup>163</sup> Rose-Ackerman 1999, p. 209.

<sup>164</sup> Ayub 1987, p. 87.

<sup>165</sup> Ibid., p. 98.

treated government as a type of inferior good and fixated on fiscal consolidation, might have robbed states of the ability to institute “systemic, proactive public interventions that can assist the private sector in overcoming structural constraints on innovation, productive transformation and export development.”<sup>166</sup> As discussed, there is no quarreling with the depressing data on the failures of state-owned enterprises. Defenders of state-led development, however, blame those stumbles on the “lack of experience, competence and expertise among personnel charged with carrying out projects; the diversion of needed funds to other uses; and the subversion of reform goals by politicians and bureaucrats uncommitted, for whatever reason, to their achievement.”<sup>167</sup> True, state-owned enterprises have been a breeding ground for corruption. But corruption is not only present in countries with governments that operate large businesses. Infamously, in the former Soviet states and elsewhere, it was market *liberalization* that led to, or at minimum exacerbated, widespread corruption.<sup>168</sup> This was particularly true of botched privatizations, where government officials put insider information up for sell. It remains true in the private sector today, as was notoriously demonstrated by the Enron bankruptcy in the United States in 2001. Critics of the Washington Consensus also reject the inevitability of special interests capturing public institutions, including state-owned enterprises. As David Truman has observed, civil society can provide effective checks and balances on state capture through “overlapping membership;”<sup>169</sup> as individuals join multiple groups – protectionist manufacturers, for example, are also consumers – no

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<sup>166</sup> Robert Devlin and Graciela Mogueillansky, *Breeding Latin American Tigers: Operational Principles for Rehabilitating Industrial Policies* (Washington D.C.: World Bank Publishers, 2011), p. 2.

<sup>167</sup> Geddes 1996, p. 15.

<sup>168</sup> Daniel Kaufmann, “Economic Reforms: Necessary but Not Sufficient to Curb Corruption?” in *Curbing Corruption: Toward a Model for Building National Integrity*, eds. Sahr J. Kpundeh and Rick Stapenhurst (Washington, D.C.: World Bank, 1999), p. 90.

<sup>169</sup> David B. Truman, *The Governmental Process: Political Interests and Public Opinion* (New York City, N.Y.: Knopf, 1971), p. 599.

individual wants any single group to dominate society. Additionally, the prospect of the formation of a rival group limits overreach by influential associations and economic actors.<sup>170</sup> Europe offers examples. Some of the world's least corrupt countries – including Denmark, Finland, the Netherlands and Sweden – have some of the world's largest public sectors.<sup>171</sup> The economic development focus of various international institutions has gradually shifted to reflect this new thinking on the proper role of government. The United Nations Development Program, for example, has deemphasized budget cutting, instead calling for greater spending on fighting poverty and investing in health and education. As early as the mid-1980s, scholars were already making the case for “bringing the state back in.”<sup>172</sup> Peter Evans warned that “attempts to dismantle the state or make it wither away risk perverse consequences.”<sup>173</sup> Anyway, he wrote, “state involvement is a given. The appropriate question is not ‘how much’ but ‘what kind?’”<sup>174</sup> Vivek Chibber made a similar argument: “The choice is over *how* to have the state intervene in the economy, not *whether* to have it intervene” (emphasis in original).<sup>175</sup>

Case studies have challenged the conventional wisdom that “state intervention in the economy necessarily generates distortions that hurt economic growth,” a claim Atul Kohli rejected as “plagued by empirical and logical problems.”<sup>176</sup> By contrast, industrialization has often *depended upon* state intervention, as seen in Brazil, India and

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<sup>170</sup> Mancur Olson Jr., “The Logic of Collective Action,” in *Interest Group Politics in America*, ed. Robert H. Salisbury (New York City, N.Y.: Harper & Row, 1970), p. 15.

<sup>171</sup> Vito Tanzi, “Corruption Around the World: Causes, Consequences, Scope and Cures,” *IMF Staff Papers* Vol. 45, No. 4 (1998): p. 566.

<sup>172</sup> Peter Evans, Dietrich Rueschemeyer and Theda Skocpol, eds., *Bringing the State Back In* (Cambridge, United Kingdom: Cambridge University Press, 1985).

<sup>173</sup> Peter B. Evans, *Embedded Autonomy* (Princeton, N.J.: Princeton University Press, 2001), p. 4.

<sup>174</sup> *Ibid.*

<sup>175</sup> Vivek Chibber, *Locked in Place* (Princeton, N.J.: Princeton University Press, 2011), p. 243.

<sup>176</sup> Atul Kohli, *State-Directed Development, Political Power and Industrialization in the Global Periphery* (Cambridge, United Kingdom: Cambridge University Press, 2004), p. 376.

South Korea.<sup>177</sup> The private sector powerhouses in Japan have long enjoyed government-guaranteed financing, tax breaks, publically funded marketing and other support.<sup>178</sup> True, there are always voices proclaiming the state not only merely dead, but really most sincerely dead. Or at least downsized to “virtual” status.<sup>179</sup> However, these analystst now have to share the stage. Ha-Joon Chang, in “Kicking Away the Ladder,” argued that the biggest advocates for laissez-faire government themselves relied upon heavy state intervention to industrialize.<sup>180</sup> Great Britain, for example, was a “relatively backward economy” that imported technology and exported raw wool. That was until it banned imported wool cloth and restricted the export of raw wool to promote the development of local manufacturing. In the United States, none other than Alexander Hamilton popularized the infant industry argument and helped erect high tariffs to catalyze industrialization. (Polyani wrote “The Great Transformation” while living in Vermont.) Lately, even the authors of the Washington Consensus have begun promoting so-called “second generation” reforms that promote stronger public institutions, as well as certain capital controls.<sup>181</sup>

### **Contingent Liability**

Despite the shifting views of state-owned enterprises, there is little doubt that over all, these firms continue to struggle financially. Importantly, much of the problem arises

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<sup>177</sup> Ibid., p. 377.

<sup>178</sup> Chalmers Johnson, *MITI and the Japanese Miracle* (Palo Alto, Calif.: Stanford University Press, 1982), p. 311.

<sup>179</sup> Richard N. Rosecrance, *The Rise of the Virtual State: Wealth and Power in the Coming Century* (New York City, N.Y.: Basic Books, 1999), p. 9.

<sup>180</sup> Ha-Joon Chang, *Kicking Away the Ladder* (London, United Kingdom: Anthem, 2003).

<sup>181</sup> John Williamson, “An Agenda for Restarting Growth and Reform,” in *After the Washington Consensus: Restarting Growth and Reform in Latin America*, eds. Pedro-Pablo Kuczynski and John Williamson (Washington, D.C.: Institute for International Economics, 2003), p. 6.

from their basic ownership structure, in which the officials in charge have no financial stake in the business's success. The consequences are not merely academic. For large countries, state-owned enterprises might be wasteful, but they are not systemically dangerous. In small states, however, they at times present an almost existential threat. The danger lies in what is known dryly as contingent liability; though a state-owned enterprise might be financially independent on paper, economic and political factors compel central government bailouts in tough times. The problem is that the veneer of independence permits governments to avoid establishing adequate reserves to address a "major hidden fiscal risk."<sup>182</sup> It also creates a moral hazard that leads state-owned enterprises to borrow irresponsibly. This is obviously the case with explicit government guarantees, but it also occurs with an implicit promise of rescue.

"Once a contingent liability falls due and requires government financing, however, the government has limited choices: it can increase the deficit, incur additional public liabilities without reporting any increases in the deficit, cut some envisaged expenditures, levy more taxes, sell state assets, default on some obligations or engage in some combination of these activities. Each of these actions challenges government performance and credibility, with an attendant reduction in the effectiveness of future policies, compromises political stability and impairs future performance and growth in the overall economy."<sup>183</sup>

The same is true for privatizations that provide government guarantees to private investors.<sup>184</sup>

Better planning is frequently complicated by the lack of transparency in state-owned enterprises. Readers of the reports the IMF publishes after Article IV

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<sup>182</sup> Hana Polackova, "Contingent Liabilities, a Threat to Fiscal Stability" *World Bank PREM Notes* No. 9 (1998).

<sup>183</sup> Polackova, Hana, *Contingent Government Liabilities: A Hidden Risk for Fiscal Stability*, 1999, Policy Research Working Papers, Washington, D.C.: The World Bank, p. 10.

<sup>184</sup> World Bank, Timothy Irwin, Michael Klein, Guillermo E. Perry and Mateen Thobani, "Dealing with Public Risk in Private Infrastructure," January 1998.

consultations – the periodic, economic full body scans that detect signs of economic distress – are familiar with this challenge. In 2012, for example, the IMF mission to the Caribbean island of Grenada discovered that it was “very difficult to monitor and assess SOEs financial status since they don’t report systematically.”<sup>185</sup> Despite a law mandating reporting, less than half of the country’s 29 state-owned enterprises submit audited financial statements to parliament. The situation is similar throughout the Caribbean, where small islands favor big governments. In 2011, IMF staff warned Barbados about its subsidies to state-owned enterprises, recommending it “consider privatization and outsourcing where feasible.”<sup>186</sup> As with Grenada, Barbados’s 2011 Article IV report highlighted a lack of transparency at state-owned enterprises, complaining that “data are not systematically and promptly reported.”<sup>187</sup> Two years later, IMF inspectors again singled out Barbados’s public enterprises. This time, Barbados was in the “throes of a financial meltdown.”<sup>188</sup> The IMF recommended that the country appoint a high-level oversight committee to police state-owned enterprises, notorious for flouting laws requiring financial reporting and subject to political interference.

“Oversight and accountability with respect to the operations of the statutory bodies is lacking. The Ministry of Finance confirmed that most SOEs have not submitted financial reports for several years, undermining the fiscal planning framework and the integrity of the budget process. The decision to reduce transfers to public enterprises is welcome, but these must translate into reforms at public enterprises in order for the adjustment to be effective. In particular, new business plans are needed to inform resource allocation, staffing, whether to spin off commercial activities, how to improve targeting of support to the vulnerable groups and whether to raise tariffs.”<sup>189</sup>

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<sup>185</sup> International Monetary Fund, *Grenada Article IV Report*, 2012, Washington, D.C.: International Monetary Fund, p. 15.

<sup>186</sup> International Monetary Fund, *Barbados Article IV Report*, 2011, Washington, D.C.: International Monetary Fund, p. 9.

<sup>187</sup> *Ibid.*, p. 10.

<sup>188</sup> James S. Henry, “Postcard From Barbados, a.k.a. ‘Cyprus West,’” *Forbes*, December 18, 2013.

<sup>189</sup> International Monetary Fund, *Barbados Article IV Report*, 2013, Washington, D.C.: International Monetary Fund, p. 14.



Seven of Barbados's nine largest state-owned enterprises lose money – including the Caribbean Broadcasting Corporation and Queen Elizabeth Hospital – even when government subsidies are counted as revenue. A government task force recommended that 18 of the 40 state-owned enterprises be closed or merged to avoid redundancy and inefficiency. Nevertheless, the overall risk to the central government is hard to pin down. “The lack of up-to-date financial information means that a significant element of the public finances is not being reflected in the government's fiscal planning. These include contingencies to the central government resulting from off balance sheet activities, implicit loan guarantees and the accumulation of arrears to suppliers.”<sup>190</sup>

### **Dragging Down the Average: Latin America**

In Latin America since the 1920s, the national oil company has been the emblematic state-owned enterprise. The region set the global trend of oil nationalizations, starting with Mexico (1938), Colombia (1951), Brazil (1954), Ecuador (1973) and Venezuela (1976).<sup>191</sup> (Other regions followed, with nationalizations in Egypt in the 1960s and Iraq, Algeria and Saudi Arabia in the 1970s.) The performance of Latin America's petroleum behemoths conforms to the worst case scenario predicted by Washington Consensus economists. In fact, some scholars blame Latin America for the very concept of the “resource curse”; the region's extraordinary indebtedness and stagnant economies in the 1980s overwhelmed previous cases where favorable resource endowments were correlated with relative prosperity.<sup>192</sup> For this reputation, Latin America cannot blame

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<sup>190</sup> Ibid., p. 28.

<sup>191</sup> C.A. Heller, *The Birth and Growth of the Public Sector and State Enterprises in the Petroleum Industry* (New York City, N.Y.: Pergamon Press, 1980), p. 11.

<sup>192</sup> Manzano 2007, p. 60.

declining terms of trade, a longtime regional hobbyhorse that has not always withstood the test of accumulating data<sup>193</sup> (though it continues to have defenders<sup>194</sup>). Instead, the causes of Latin America's underdevelopment include public corruption, patronage, and government meddling that erodes trust between the "technostructure" and its government overseers.<sup>195</sup> History might have played a role. Spanish capitalism involved centralized, royal control over underground resources as well as tobacco and other products.<sup>196</sup> But the more likely culprit for overeager and underwhelming economic management is politics, with considerations such as plant location and prices commonly residing in the hands of politicians instead of businessmen.<sup>197</sup>

However it came about, the results of the region's missed opportunities can be measured in current account deficits and lost foreign exchange. Again, the oil sector is emblematic. In 2011, Argentina became a net energy importer, despite enviable oil and natural gas reserves.<sup>198</sup> Due to inadequate investment in refining capabilities, over the last decade Latin America doubled its reliance on the United States for diesel and gasoline.<sup>199</sup> The situation is not improving; by 2020, Latin America is expected to import 9 million to 10 million barrels of oil per day. "The failures of governments to establish a national consensus on public enterprises deprived the firms of a relatively fixed and stable

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<sup>193</sup> John T. Cuddington, Rodney Ludema and Shamila A. Jayasuriya, "Prebisch-Singer Redux," in *Natural Resources, Neither Curse nor Destiny*, eds. William Francis Maloney and Daniel Lederman (Washington, D.C.: World Bank), p. 134.

<sup>194</sup> José Antonio Ocampo and María Ángela Parra, "The Terms of Trade for Commodities in the Twentieth Century," *Cepal Review* (2003).

<sup>195</sup> George Philip, *Oil and Politics in Latin America: Nationalist Movements* (Cambridge, United Kingdom: Cambridge University Press, 1982), p. 493.

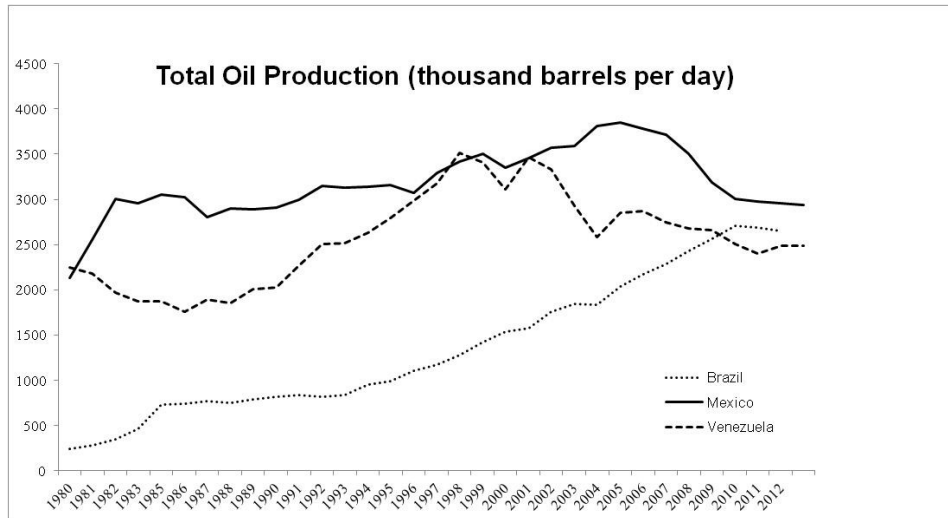
<sup>196</sup> John D. Wirth, "Introduction," in *The Oil Business in Latin America: The Early Years*, ed. John D. Wirth (Washington, D.C.: Beard Books, 2001).

<sup>197</sup> Horacio Boneo, "Political Regimes and Public Enterprises," *Institute of Latin American Studies Technical Papers Series No. 31*, The University of Texas at Austin (1981).

<sup>198</sup> "It's Official Now: Argentine Oil and Gas Production Continues to Fall," *MercoPress*, March 29, 2013.

<sup>199</sup> Parraga, Marianna, "Analysis: Latin America Grows Increasingly Hooked on U.S. Fuel Imports," *Reuters*, November 17, 2013.

environment and subjected their operating milieus to the vagaries of political, regime, ministerial or bureaucratic changes.” From the start, “continual change became the only constant for most petroleum enterprises – change of company name, change of organizational goals, change of corporate form, change of management structure and change in the company-government interface.”<sup>200</sup>



Mexico nationalized its oil sector and established Pemex to promote industrialization through universal access to cheap oil. From the start, however, political goals such as import substitution, prevailed over Pemex’s business priorities. The industrialization scheme failed. Until the North American Free Trade Agreement, Mexico was basically an oil-exporting economy. Pemex, meanwhile, served as a “bottomless font of patronage.”<sup>201</sup> To this day, the company is chronically deprived of resources.

Underfunding has taken a toll. Over the past decade, production has fallen from 3.5 million barrels per day to less than 3 million.<sup>202</sup> (The country’s drug war, of course, has

<sup>200</sup> Alfred H. Saulniers, “The State Companies: A Public Policy Perspective,” in *Latin American Oil Companies and the Politics of Energy*, ed. John D. Wirth (Lincoln, Neb.: University of Nebraska Press, 1985), p. 254.

<sup>201</sup> Saulniers 1985, p. 231.

<sup>202</sup> Geopolitical Information Service, *Energy in Latin America*, July 7, 2011.

not helped; the violence has touched Pemex through kidnappings of executives and oil theft from pipelines by drug cartels.<sup>203</sup>) In Argentina, the state oil company Yacimientos Petrolíferos Fiscales, known as YPF was taxed into oblivion. The situation in Brazil is worse. Brazil's state-owned Petróleo Brasileiro, known as Petrobras, should be flying high. In 2006, it found massive off-shore oil deposits and boasted that the discovery would "catapult the company, in the upcoming years, to a new oil reserve and production level, ranking it among the major operators."<sup>204</sup> Eventually, the company promised, the fields would yield more than a million barrels of oil per day. That might still prove true. However, for now, the company resembles the region's classic "parasitic parastatal."<sup>205</sup> The so-called pre-salt oil – 23,000 feet below the sea, beneath rocks covered by a layer of salt that is in some places 6,562 feet thick – has not transformed Petrobras's fortunes. Production has dropped to 1.9 million barrels per day from 2.11 million in 2011.<sup>206</sup> In 2008, Petrobras was ranked as the world's sixth-largest company. Since then, its market value has dropped by one-third.<sup>207</sup> The company suffers from a headache shared by its counterparts throughout the region: the forced provision of subsidized oil to domestic consumers. It pursues this policy despite the fact that in Brazil, as elsewhere, the biggest oil users are typically the wealthiest in society. The subsidies proved increasingly costly

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<sup>203</sup> Jeremy Martin and Sylvia Longmire, "The Perilous Intersection of Mexico's Drug War & Pemex," *Journal of Energy Security* March (2011).

<sup>204</sup> Petróleo Brasileiro, *Operations in the Pre-Salt*, <http://www.petrobras.com/en/energy-and-technology/sources-of-energy/pre-salt/>.

<sup>205</sup> Saulniers 1985, p. 226.

<sup>206</sup> Cowley, Matthew and Paulo Trevisani, "Brazil Seen Having To Alter Oil Rules," *The Wall Street Journal*, October 23, 2013.

<sup>207</sup> Idoeta, Paula Adamo, "Brazil's Energy Giant Petrobras is Mired in Controversy," *BBC*, April 8, 2014.

as economic growth in Brazil<sup>208</sup> increased sales of cars and trucks and the demand for petroleum products outpaced domestic production.<sup>209</sup> Over all, primary energy consumption in Brazil increased by more than one third over the past decade.<sup>210</sup> As a result, Petrobras imports fuel at world prices and sells it at a considerable loss. The imports – as much as 215,000 barrels per day of gasoline and diesel – have taken a toll; since 2011, Petrobras’s refining division has lost \$18.3 billion.<sup>211</sup> (This was before oil prices collapsed and a bribery scandal devastated the company.) There are reasonable reasons to maintain the interventionist policies, including a desire to control inflation. The company’s projected growth also makes it an attractive tool for industrial policy, as a potential driver of employment in a range of industries, such as shipbuilding. Domestic politics is also a factor. Many Brazilians, including Petrobras workers, have been suspicious of the company since it was partially privatized in 1997. (Brazil established Petrobras in 1953, the culmination of “the oil is ours” movement, and it maintained its monopoly over the industry for 44 years.) Debate over how to handle the pre-salt oil and its promised riches has sparked protests, including an “Occupy Petrobras” encampment at the company’s Rio de Janeiro headquarters.

None of that lessens the impacts on company finances. The losses are particularly worrisome in light of another government mandate: that Petrobras and local partners receive a majority of contracts for drills, ships and platforms needed to extract the

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<sup>208</sup> Brazil’s economy grew rapidly before the 2009 global financial crisis, expanding by 6.1 percent in 2007 and 5.2 percent in 2008, according to the United Nations’s Economic Commission for Latin America and the Caribbean.

<sup>209</sup> Fick, Jeff, “Petrobras Shares Jump on Proposed Fuel-Pricing Mechanism, Proposed Policy Is Silver Lining in Otherwise Lackluster 3rd-Quarter Report,” *The Wall Street Journal*, October 28, 2013.

<sup>210</sup> U.S. Department of Energy, Energy Information Administration, *Brazil*, 2013, Washington, D.C.

<sup>211</sup> Pearson, Samantha and Joe Leahy, “Petrobras: Unfulfilled Potential,” *The Financial Times*, October 17, 2013.

estimated 50 billion barrels of pre-salt oil.<sup>212</sup> To play its outsized part, Petrobras needs all the cash it can get its hands on. The required subsidies on domestic gasoline sales, however, are forcing it to borrow to cover the \$237 billion in planned investment over the next five years. As a result, the company's debt has jumped to \$185 billion from \$40 billion in 2008.<sup>213</sup> In the first six months of 2013, debt increased by \$16.3 billion.<sup>214</sup> Petrobras's total borrowing in 2013 – \$20 billion – included an \$11 billion bond sale that was the largest ever for an emerging market company.<sup>215</sup> Petrobras now owes \$86.5 billion, making it the world's most indebted oil company. Meanwhile, the required participation of local firms is causing further complications. Under government rules, Petrobras is guaranteed a 30 percent stake in every project and operates the fields. Foreign partners must buy half of their supplies locally, regardless of cost. The impact of this "state-heavy strategy"<sup>216</sup> was evident in October 2013, when Brazil auctioned off the first pre-salt field, five years after it discovered the oil. Several multinational oil companies stayed on the sidelines, including Exxon and Chevron, in part because of the leading role reserved for Petrobras in the development of the Libra field.<sup>217</sup> The government's required \$7 billion signing bonus and 80 percent cut of the proceeds also dampened enthusiasm.<sup>218</sup> The month of the auction, Moody's Investors Service downgraded Petrobras, to Baa1 from A3, citing its high debt and negative cash flow.

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<sup>212</sup> "Petrobras, Over a Barrel," *The Economist*, September 2, 2010.

<sup>213</sup> Pearson 2013.

<sup>214</sup> Moody's Investors Service, *Rating Action: Moody's Downgrades Petrobras Long-term Debt Ratings to Baa1*, October 3, 2013, New York City, N.Y.

<sup>215</sup> Fick, Jeff, "Petrobras Expects to Raise Less from Debt Markets in 2014, Higher Crude Oil Output to Lessen Need for Funding, Finance Chief Says," *The Wall Street Journal*, January 15, 2014.

<sup>216</sup> Lyons, John and Fick, Jeff, "Brazil Moves to Join Other Major Oil Nations," *The Wall Street Journal*, October 22, 2013.

<sup>217</sup> Fick, Jeff, "Brazil Oil Auction Draws Industry Interest and Popular Protest," *The Wall Street Journal*, October 20, 2013.

<sup>218</sup> Cowley 2013.

“Political pressures,” Moody’s wrote, meant no end was in sight to petroleum subsidies. None of this is new for Petrobras. In the 1980s, Brazilian policymakers used Petrobras to bail out a variety of foundering industries through its purchases of alcohol, pig iron and steel, and sales of subsidized fertilizer and petrochemicals.<sup>219</sup> (Chapter 6 discusses Petrobras’s recent, extreme struggles amid an apocalyptic corruption scandal.)

This cross-subsidizing by state-owned enterprises is common in the region. Historically in Argentina, the state oil company not only provided discounted crude to the state-owned railway, but turned a blind eye when the railway failed to pay its bills. (Pemex was also hurt by a deadbeat state-owned railroad.) Nor is Petrobras the only national oil company to contend with debilitating government mandates. In Venezuela, the government’s agenda for *Petróleos de Venezuela*, known as PDVSA, extends far beyond profitability. As in Brazil, conflicting mandates have eroded PDVSA’s profits and productivity. Former President Hugo Chávez (1999 to 2013) “long opposed PDVSA’s strategy of maximizing market share through increased production, reinvestment of profits abroad and lower prices.”<sup>220</sup> Once in office, he attacked the state-owned enterprise’s independence. His efforts provoked two major worker strikes. Ultimately, however, he succeeded in seizing control, after he dismissed PDVSA’s president and 18,000 workers and executives, and replaced its governing board. Having converted PDVSA into a presidential slush fund, Chávez habitually diverted its revenues to social programs, state projects and foreign assistance. For more than a decade, oil proceeds financed “ambitious public spending, wage hikes, extension of credit to traditionally marginalized sectors, nationalization schemes [and] limits on private-sector

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<sup>219</sup> Wirth 2001.

<sup>220</sup> Jennifer McCoy, “Conclusion,” in *The Unraveling of Representative Democracy in Venezuela*, ed. Jennifer McCoy and David Meyers (Baltimore, Md.: Johns Hopkins University Press, 2004), p. 287.

firings.”<sup>221</sup> Revenues also paid for clientelistic “social missions” – providing health care, schooling and housing to poor communities where the government enjoyed strong support – and for a chain of discount convenience stores. The program remains the largest of its kind in Latin America.<sup>222</sup>

Previous governments also raided PDVSA’s accounts. Former President Luis Antonio Herrera Campins (1979 to 1984), for example, extracted billions of dollars from a special account set up to preserve 10 percent of the company’s profits for its internal use. However, the extraction of revenues by Chávez and his successor, Nicolás Maduro (2013 to present), has been dramatic. Ultimately, it has made it impossible for PDVSA to invest in its infrastructure or in oil exploration. That handicap – coupled with a nationalization spree that discouraged foreign direct investment in Venezuela – had predictable consequences. Oil production fell by 30 percent under Chávez.<sup>223</sup> In November 2013, Petrobras pulled out of a joint refinery after PDVSA could not come up with its portion of the cash.<sup>224</sup> At the same time, Chávez directed PDVSA to supply gasoline at extraordinarily low prices domestically. Today, gasoline in Venezuela is the cheapest in the world; with the price fixed at 6 cents per gallon for the past 15 years, drivers spend more tipping the gas station attendant than filling their tank.<sup>225</sup> Thanks to refining challenges, PDVSA imports much of its gasoline, paying world prices.

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<sup>221</sup> Manuel Hidalgo, “Hugo Chávez’s ‘Petro-Socialism,’” *Journal of Democracy* Vol. 20, No. 2 (2009): p. 81.

<sup>222</sup> Michael Penfold-Becerra, “Clientelism and Social Funds: Evidence from Chávez’s Misiones,” *Latin American Politics and Society* Vol. 49, No. 4 (2007): p. 65.

<sup>223</sup> Clayton, Blake, *Chávez’s Troubled Legacy for Venezuela’s Oil Industry*, Energy, Security and Climate blog (Washington, D.C.: Council on Foreign Relations, January 17, 2013).  
<http://blogs.cfr.org/levi/2013/01/17/Chavez-troubled-legacy-for-venezuelas-oil-industry/>

<sup>224</sup> Goodman, Joshua, “Venezuelan Oil Diplomacy Curbed by Economic Crisis,” *Associated Press*, December 2, 2013.

<sup>225</sup> Neuman, William, Venezuela May Meet New Reality, and New Price, at the Pump, *The New York Times*, January 20, 2014.



Meanwhile, the subsidized oil promotes profligate consumption; since 2001, domestic consumption is up 39 percent.<sup>226</sup> That, in turn, cuts into oil exports, which account for 95 percent of the country's export earnings.<sup>227</sup>

## **Falling Behind**

In attempts to explain why Latin America “fell behind” other developing regions – a popular academic pastime – the missteps of Latin American state-owned enterprises loom large. This was not the only factor by a long shot. The region also suffered from its historic failures to invest in human capital, reduce inequality and address poverty, as well as its weak institutions and onetime passion for autarchic economic policies.<sup>228</sup> Still, Latin America's poor management of state-owned enterprises plays an important role in comparative studies. Like Latin America, the Scandinavian countries (Denmark, Finland, Norway and Sweden) were poor, agricultural and burdened by income inequality until the mid-1950s. As in Latin America, Scandinavia relied heavily upon natural resources, such as timber and iron ore, for economic growth. The similarities, however, diminished over the next three decades. Scandinavian industrial policy focused on promoting private sector exports, taking advantage of a sustained and dramatic expansion of international trade. In Latin America, import substitution industrialization, largely through state-owned enterprises, dominated. As a result, per capita GDP in Finland, once equal to the levels in

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<sup>226</sup> U.S. Department of Energy, Energy Information Administration, *Venezuela*, 2012, Washington, D.C.

<sup>227</sup> Organization of the Petroleum Exporting Countries, *Venezuela Facts and Figures*, [http://www.opec.org/opec\\_web/en/about\\_us/171.htm](http://www.opec.org/opec_web/en/about_us/171.htm).

<sup>228</sup> Jorge Domínguez, “Explaining Latin America's Lagging Development in the Second Half of the Twentieth Century,” in *Falling Behind*, ed. Francis Fukuyama (New York City, N.Y.: Oxford University Press, 2008), p. 94.

Chile and Uruguay, was nearly three times as high by the mid-1980s.<sup>229</sup> In Sweden and Finland, the forest and metal industries still account for at least one-fifth of the industrial labor force and produce a quarter of exports.<sup>230</sup> At the same time, Scandinavia's export-orientated, private sector firms – such as Sweden's Ericsson and Finland's Nokia – have gained global market share in a way almost none of Latin America's state-owned enterprises ever did. Latin America, a region whose economic growth was long based on exports, saw its share of world trade fall by half between 1950 and 1980.<sup>231</sup>

Perhaps the most common and least flattering comparison is Latin America and East Asia. Though the Asian Tigers – Hong Kong, Taiwan, South Korea and Singapore – were as *dirigiste* as Latin American governments in the early post-war period, those states directed investment through market-oriented, export-focused policies, and focused on bolstering private sector firms.<sup>232</sup> The resulting economic “miracle” again drew attention to the plight of Latin American “laggards.”

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<sup>229</sup> Magnus Blomström and Patricio Meller, “Introduction,” in *Diverging Paths: Comparing a Century of Scandinavian and Latin American Economic Development*, ed. Magnus Blomström and Patricio Meller (Washington, D.C.: Inter-American Development Bank, 1991), p. 3.

<sup>230</sup> Magnus Blomström and Ari Kokko, “From Natural Resources to High-Tech Production: The Evolution of Industrial Competitiveness in Sweden and Finland,” in *Natural Resources, Neither Curse nor Destiny*, ed. William Francis Maloney and Daniel Lederman (Washington, D.C.: World Bank), p. 214.

<sup>231</sup> José Antonio Ocampo, “Latin America and the World Economy in the Long Twentieth Century,” in *The Long Twentieth Century, the Great Divergence: Hegemony, Uneven Development and Global Inequality*, ed. K.S. Jomo (New York City, N.Y., 2006), p. 70.

<sup>232</sup> Stephan Haggard, “The Newly Industrializing Countries in the International System,” *World Politics* Vol. 38, No. 2 (1986).

### **Chapter 3: Has the Panama Canal Authority efficiently managed the canal, and even exceeded the U.S. record? Assessing Panama's premier state-owned enterprise**

#### **Introduction**

C.B. Fenton has been servicing ships in the Panama Canal since 1916, two years after the waterway opened. For a century, it has ferried mail and newspapers aboard launches to transiting vessels; transported crewmembers to shore for doctors appointments; arranged ship repairs; and, like a maritime bail bondsman, hunted down crewmembers who failed to return from shore leave. As the U.S. government prepared to get out of the canal business in 1999, C.B. Fenton executives held their breath.

The company's president, Robin Morland, had spent his life in the Panama Canal Zone. Born in 1942 in Colón, he attended Cristóbal High School, riding the historic Panama Canal railway to play the Balboa High School Bulldogs in baseball. His father, Gilbert Morland, had moved to Panama in 1931. He married the daughter of a Brooklyn mariner who in 1916 began piloting ships through the locks. In 1958, he bought C.B. Fenton. Twenty years after Carter and Torrijos signed the canal treaties, Robin Morland was not convinced Panama was prepared to run the waterway. He worried about workers knocking off early, inadequate dredging and having to pay bribes to move ships through the locks.

As it turned out, Panama did not stumble out of the gate. The Panama Canal Authority, Morland said, processes paperwork in a flash, accommodates last-minute requests – say, for tugboat assistance through the locks – and makes rapid-fire decisions

compared to the previous U.S. administration. “Panama has done a wonderful job,” he said. “It’s a business now. Everyone has been pleasantly surprised.”<sup>233</sup>

Morland is not alone in his praise for the Panama Canal Authority. Against all odds, Panama’s premiere state-owned enterprise has exceeded practically all expectations. Panama’s performance has been mostly overlooked; sidestepping management missteps is hardly front page news in a region where governance failures have opened the door to gangland mayhem and rampant drug running.<sup>234</sup> But those who come in contact with Panama’s canal are universally impressed. “If you look at performance metrics, they haven’t fallen down anywhere,” Christopher L. Koch, president of the World Shipping Council, a leading industry group, said. “They have done a fine job of it.”<sup>235</sup> Noel Maurer, co-author of a 2010 history of the canal, “The Big Ditch: How America Took, Built, Ran and Ultimately Gave Away the Panama Canal,” agreed. “The Panama Canal is now better managed than ever before,” he concluded.<sup>236</sup>

### **Performance Metrics**

Panama’s strong performance is evident in most quantitative measures. The canal authority is obsessed with metrics. It clocks a ship’s time crossing canal waters; how often line handlers meet a ship on time; how frequently tugboats are out of service; and the punctuality of canal pilots navigating the locks. To keep tabs on environmental

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<sup>233</sup> Interview by author with Robin Morland, August 26, 2013, Panama City, Panama.

<sup>234</sup> In the United Nations Office on Drugs and Crime’s 2013 “Global Study on Homicide,” Panama’s neighbors stood out as the most violent countries on earth, led by Honduras, which registered 90.4 homicides per 100,000 residents. By contrast, Panama saw 17.2 homicides per 100,000 residents.

<sup>235</sup> Interview by author with Christopher L. Koch, September 5, 2014.

<sup>236</sup> Noel Maurer, “The Last Word, The Canal and Beyond,” *Revista*, 2013.

conditions in the canal watershed, the authority monitors 22 indicators including forest cover, water quality and farming practices.<sup>237</sup>

Throughout the 1990s, observers predicted a Three Stooges routine of bumbling seamen. Instead, in its first full year running the canal, toll revenue increased by \$5.3 million and the accident rate fell to its lowest level since 1947.<sup>238</sup> In the 2003 fiscal year, the authority supervised 172 days free of accidents, the best performance in a half century.<sup>239</sup> The accident rate remained low in subsequent years, thanks to training and investments in navigational aids such as lighthouses, buoys, beacons, bank lights and technology for pilots.

Panama's success is most evident in the category most important to Panamanians: profit. From 2000 – Panama's first year running the waterway – to 2013, net income rocketed to \$1.2 billion from \$142 million, a nominal increase of more than 800 percent (Figure 1). Toll revenues – the main driver of profits – exploded. In 2000, the canal collected \$430 million from passing vessels; in 2013, shippers handed over \$1.8 billion. Total revenue in 2013 hit \$2.4 billion, compared to \$769 million in 2000. It helped that the canal faced no direct competition, permitting it to set the market price for its services. Tolls have risen repeatedly, and significantly, under the Panamanians; up twice in 2002 (8 percent, 4.5 percent); three times in 2007 (5.7 percent, 14.2 percent and 10.1 percent); and once in 2011 (12 percent), 2012 (5 percent) and 2013 (5 percent). Changes in the toll structure also inflated revenues, after Panama instituted a system that charged different fees for different classes of ship, such as container ships and tankers. Panama also

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<sup>237</sup> Panama Canal Authority, Annual Report, 2005.

<sup>238</sup> For the 2001 fiscal year (October 1, 2000 to September 30, 2001), the authority reported 17 accidents out of 13,492 transits.

<sup>239</sup> Panama Canal Authority, Annual Report, 2003.

charges for on-deck cargo space and it operates a convenient, but exorbitantly priced, reservation system. “The transition was smooth,” Panama’s colorful ambassador to the United States, Mario E. Jaramillo, said in 2012.<sup>240</sup> “Small is beautiful.”

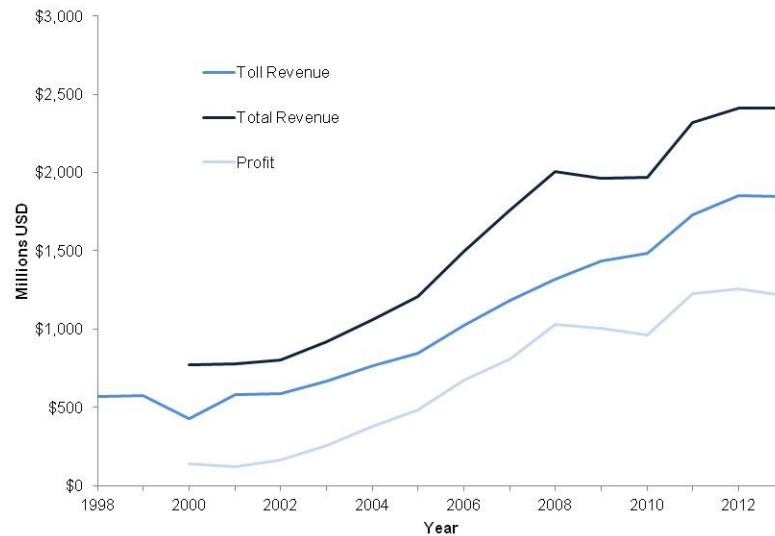


Figure 1. Panama Canal Authority financial performance

From day 1, shippers did not stray to alternate routes (Figure 2). “Panama has won over its skeptics, proving that a small Central American country can manage one of the world’s greatest maritime shortcuts as efficiently as the United States,” the *Journal of Commerce*, a major industry publication, concluded in 2002.<sup>241</sup> The same year, *Lloyd’s* said any doubts about Panama’s ability to run the canal had “totally disappeared.”<sup>242</sup> “The ships didn’t crash,” Ricaurte Vásquez, the canal’s first Panamanian chief financial officer, said. “We were not celebrating Mardi Gras in the locks.”<sup>243</sup>

<sup>240</sup> Mario E. Jaramillo (Remarks at the Council on Foreign Relations, Washington, D.C., November 19, 2012).

<sup>241</sup> Omar Jaén Suárez, *Diez Años de Administración Panameña del Canal* (Panama City, Panama: Panama Canal Authority, 2010), p. 222.

<sup>242</sup> *Ibid.*, p. 222.

<sup>243</sup> Interview by author with Ricaurte Vásquez, Panama City, Panama, August 2, 2013.

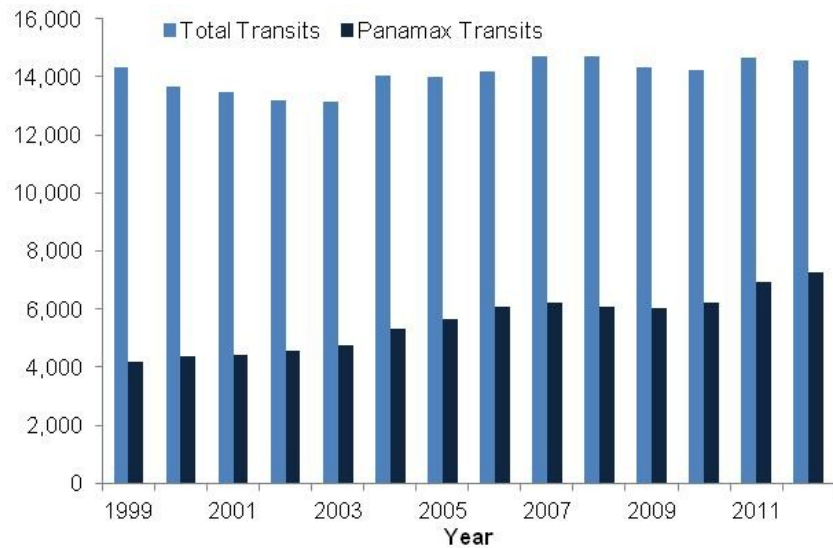


Figure 2. Transits through the Panama Canal

Panama recorded similar trends in the quantity of cargo it has handled. Tonnage increased in all but three of the first 14 years Panama controlled the canal (Figure 3), as the waterway drew increasingly larger ships.<sup>244</sup> The cargo includes everything from wheat, sorghum, corn and rice to crude oil and gasoline, iron, copper and zinc, coal, chemicals, salt, fertilizers, cars and trucks, lumber, and sugar and bananas, all hauled aboard container vessels, dry bulk carriers, refrigerated ships, tankers and vehicle carriers. From 2000 to 2011, tonnage increased by 3.1 percent annually on average, led by spectacular growth in containerized cargo moving between Asia and the East Coast of the United States, and buoyed by rapidly expanding vessel size.<sup>245</sup> Panama’s “ownership of the Panama Canal since the end of 1999 has been an unqualified success,” Ambler H. Moss Jr., U.S. ambassador to Panama from 1978 to 1982, said. “The canal makes more

<sup>244</sup> The iconic “Panamax” is a ship with a beam – or width – that exceeds 98 feet. Typically, Panamax ships are container carriers.

<sup>245</sup> Panama Canal Authority, Annual Report, 2011.

revenue, puts through more ships per day and has a better safety record than it did when the U.S. operated it.”<sup>246</sup>

## **Outside Factors**

Obviously, Panama’s management of the canal is hardly the only factor in its performance. The vicissitudes of global commerce also govern the fate of canal finances. There are frequent, exogenous shocks, such as the 2008 global financial crisis that sent tonnage tumbling 1.1 percent, as shipments of construction materials to the United States declined. The business cycles of major canal users – principally the United States, China and Japan – also play a role. In the 2002 calendar year, for example, growth was sluggish in the United States (1.8 percent), Japan (0.3 percent) and the Euro Area<sup>247</sup> (1 percent).<sup>248</sup> As a result, the 2002 fiscal year saw canal transits drop 2.3 percent and tonnage tumble 2.8 percent. Broader, global economic trends also register. Shifts in manufacturing to South and Southeast Asia, for example, help the Suez Canal at Panama’s expense, due to the shorter navigation time from that region’s ports to the U.S. East Coast.<sup>249</sup>

Local phenomena have outsized impacts on the canal, both positive and negative. The discovery of oil in Prudhoe Bay, Alaska, in 1968 boosted canal traffic, but traffic dropped rapidly in 1983, when the transisthmian oil pipeline opened.<sup>250</sup> The temporary closure of Venezuelan oil refineries in 2003 deprived the canal of oil tanker tolls.<sup>251</sup> The

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<sup>246</sup> Ambler H. Moss Jr., “What Impact Would Noriega’s Return Have in Panama?” *Latin America Advisor*, August 27, 2007.

<sup>247</sup> In 2002, the Euro Area consisted of Austria, Belgium, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Portugal, Spain and The Netherlands.

<sup>248</sup> International Monetary Fund, World Economic Outlook Database, October 2014.

<sup>249</sup> Leach, Peter T. “Is Panama Losing its Moxie?” *International Maritime*, Nov. 11, 2013.

<sup>250</sup> Noel Maurer and Carlos Yu, *The Big Ditch: How America Took, Built, Ran and Ultimately Gave Away the Panama Canal* (Princeton, N.J.: Princeton University Press, 2010), p. 284.

<sup>251</sup> Aghast at President Hugo Chávez’s politicization of the oil industry, among other controversial public policies, Venezuela’s largest labor union staged a general strike in April 2002. In December of that year,



spectacular growth of the Chinese economy – Chinese GDP increased by 9.2 percent on average from 1996 to 2005 – and China’s inclusion in the World Trade Organization, in 2001, produced consistent increases in Latin American raw materials shipped through the canal to China. In the other direction, total tonnage from Asia to the U.S. East Coast grew annually by 5.1 percent on average from 2000 to 2011. Economic growth in the United States lifts the quantity of Japanese cars sailing through the canal, while natural disasters in Japan, such as the 2011 Fukushima nuclear meltdown, have the opposite effect. Drought in the United States hurts the U.S. grain harvest, and lowers canal traffic. China’s astonishing appetite for coal, iron ore and oil means much of the natural resource exports from Australia, Indonesia, Africa and the Middle East stick to their own hemisphere, never touching the canal.<sup>252</sup> “The number of transits does not depend solely on the canal. It is a variable affected by various factors related to the global economy, which is impacted by natural events, wars, economic cycles, geopolitical strategies and the canal’s capacity.”<sup>253</sup> (An area for future research would involve regression analyses designed to isolate the significance of canal management from other variables that help determine canal outcomes. The relevant data is available – including variables such as annual tonnage, revenue, accidents, transit speed and personnel – dating back to at least 1980. That permits analyses that would compare U.S. and Panamanian canal management, controlling for external factors such as economic growth in the United States and Japan, both major canal users,<sup>254</sup> and over all changes in global trade patterns.)

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unions launched a second general strike, and all 18,000 workers at the state-owned oil company Petroleos de Venezuela (PDVSA) left their posts in a protest that lasted three months.

<sup>252</sup> “Panama, Suez, Nicaragua Canal Schemes Miss Trade Boat,” Agence France-Presse, September 7, 2014.

<sup>253</sup> Suárez 2010, p. 159.

<sup>254</sup> The author has compiled this data.

Industry trends matter, too. The increasing size of vessels has been doubly helpful to the Panama Canal Authority; the authority bills based on *cargo capacity*, so larger ships offer more revenue in fewer transits, potentially reducing water use in the locks, gridlock and accidents. On September 19, 2007, the authority ushered 25 Panamax vessels through the canal, a record number at the time.<sup>255</sup> Today, these gigantic container ships make up a quarter of all traffic, and provide more than half of toll revenue. Containerization was also a godsend to the Panama Canal. Dry bulk carriers once dominated the canal, hauling grain, coal and other commodities. Today, it is largely a container canal, plied by liner services running container ships on set schedules. In the future, the canal expects a boost from another outside development, the shale oil and gas revolution in the United States. That business opportunity, the result of a wholly unanticipated technological development, will send LNG shipments through the canal to Japan, South Korea, China and Taiwan. By contrast, the Trans Pacific Partnership, designed to increase trade across the Pacific Ocean, could hurt the canal's bottom line.

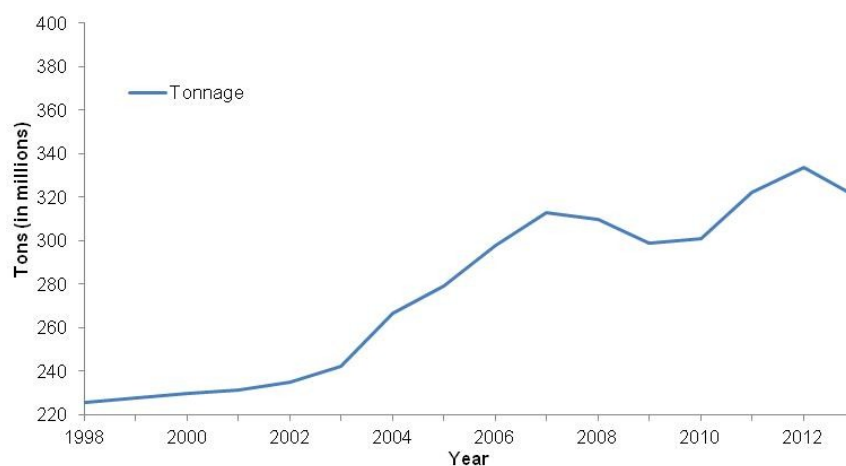


Figure 3. Total annual tonnage passing through Panama Canal

<sup>255</sup> Panama Canal Authority, Annual Report, 2007.

Against all odds, the authority has kept spending under control. As a result, its profit margin – net income divided by revenue – consistently exceeds 50 percent, up from 12.6 percent in 2000. The increased revenue and profits have provided a windfall for the Panamanian government (Figure 4). By law, after covering operating, investment, modernization and expansion costs, all surplus revenue goes to the Panamanian treasury. (The canal pays no taxes.) In 2000, the Panama Canal Authority directly contributed \$201 million to the Panamanian budget; that figure topped \$1 billion in 2011 and again in 2012. In its first decade under Panamanian management, the canal generated \$4.7 billion for government coffers, compared to a *total* of \$1.9 billion in 86 years under U.S. control.<sup>256</sup> Through 2011, the authority had plowed \$6.6 billion into the Panamanian treasury, at an annual growth rate of 16.1 percent.

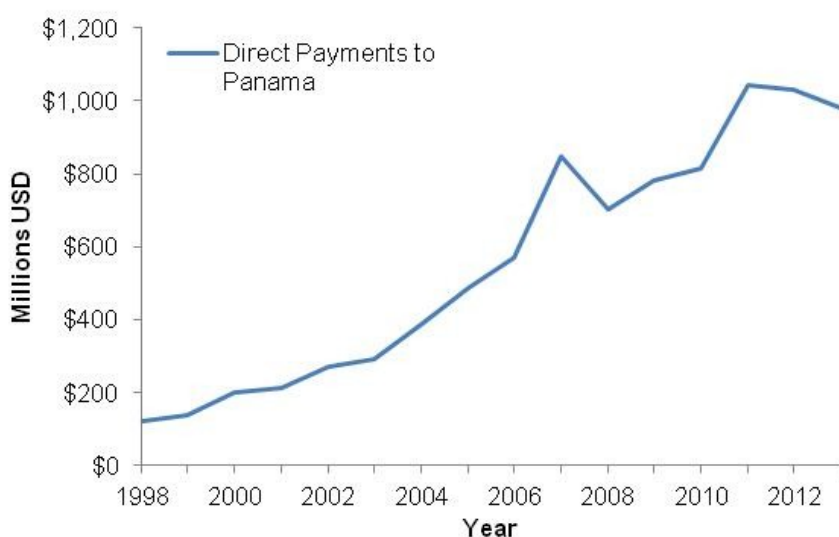


Figure 4.  
Panama Canal  
Authority  
budget support  
to Government  
of Panama

The authority also generates more than \$340 million annually in indirect payments to the Panamanian government, from sources such as employee income taxes and social security taxes. A 2008 study, commissioned by the Panama Canal Authority,

<sup>256</sup> Suárez 2010, p. 77.

found that the canal's over all contribution to Panama's GDP averaged 4.8 percent from 2000 to 2008, using a narrow definition of the canal's economic impact (Figure 5).

“This contribution exceeds 10 percent when including the multiplying impact that happens when the workers spent their salaries in the purchase of goods and services, as well as if the multiplying impact is considered over the suppliers of merchandises and services [to the canal]. A relevant conclusion of the study was that each foreign dollar received by the canal is a contribution of \$1.27 dollars to the GDP.”<sup>257</sup>

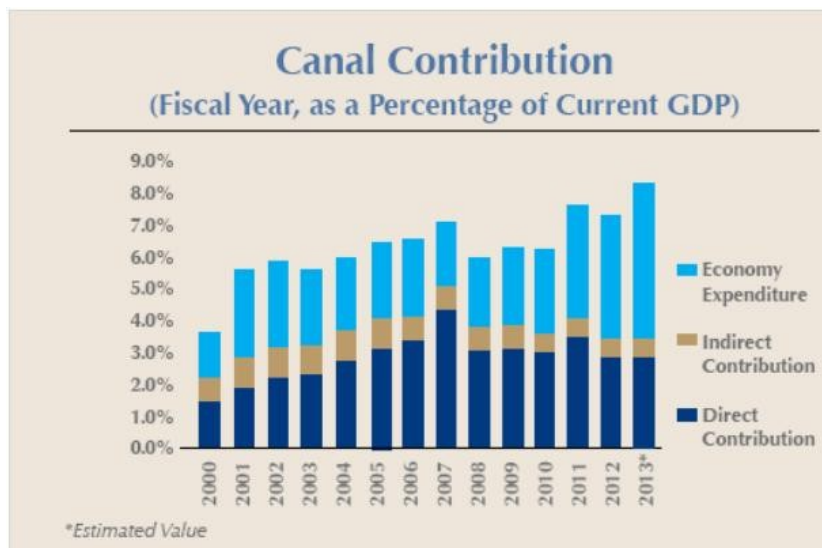


Figure 5.  
Sources of  
Panama Canal  
Authority  
budget support  
(Source:  
Panama Canal  
Authority)

The “logistic and transportation conglomerate” tied to the canal, the study found, accounts for more than a third of Panama's GDP, and 15 percent of government income. This includes activity in the sprawling Colón Free Trade Zone, as well as canal-related services such as the sale of fuel to ships; large ports on both sides of the canal; ship maintenance and repair; and water shuttle services. As an additional helping hand to Panamanian authorities, canal operating areas are company towns, where the authority handles security, firefighting, street maintenance, public lighting, street cleaning, traffic control and garbage collection. It not only provides drinking water to communities in the

<sup>257</sup> Panama Canal Authority, Annual Report, 2009.

former Panama Canal Zone, but also sells water to Panama City, San Miguelito, Colón, Arraijan and La Chorrera, cleaned in two canal-owned filtration plants, warehoused in 18 canal-owned water towers and transported, thanks to seven canal-owned pumping stations, through 43 miles of canal-owned pipes. The authority also operates two hydroelectric plants – Madden and Gatún – with an installed capacity of 36 and 24 megawatts, respectively, and a thermoelectric plant with an installed capacity of 91 megawatts. The canal, meanwhile, draws hundreds of thousands of visitors per year, magnifying its economic impact. In a world of money-losing, debt-burdened, state-owned enterprises, the Panama Canal Authority’s contributions are extraordinary.

## **Reinvestment**

Perhaps most surprising is that the authority’s consistently increasing profits have not come at the expense of capital investment. Unlike its peer state-owned enterprises – such as the Latin American oil giants Pemex (Mexico) and PDVSA (Venezuela) discussed in Chapter 2 – the Panama Canal Authority’s transfers to the Panamanian treasury are calculated only after deducting its annual capital investments. The authority is not shy about using that privilege. In some years, it reinvests more than \$300 million. Over all, through 2011, it invested \$1.9 billion in the business (Figure 6). It widened, deepened and straightened the famed Culebra Cut,<sup>258</sup> the canal’s toughest passage. Purchased tug boats. Replaced thousands of feet of tow tracks for the locomotives that pull ships through the locks, and bought modern locomotives. It deepened Gatún Lake, the artificial body of water in the center of the canal. And it bought equipment with eye-popping price tags to upgrade the aged fleet inherited from the United States, including a

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<sup>258</sup> The Culebra Cut is the narrowest section of the canal. Its eight miles in length represent a fifth of the canal.

\$100 million cutter suction dredge, a \$46 million backhoe dredge and a \$19 million drilling and blasting barge. In addition to the new equipment, it pours millions into dredging. “The fear of failing in maintenance has motivated everyone,” Abdiel Pérez, the general manager for the authority’s maintenance and locks division, which includes 2,400 employees, said.<sup>259</sup>

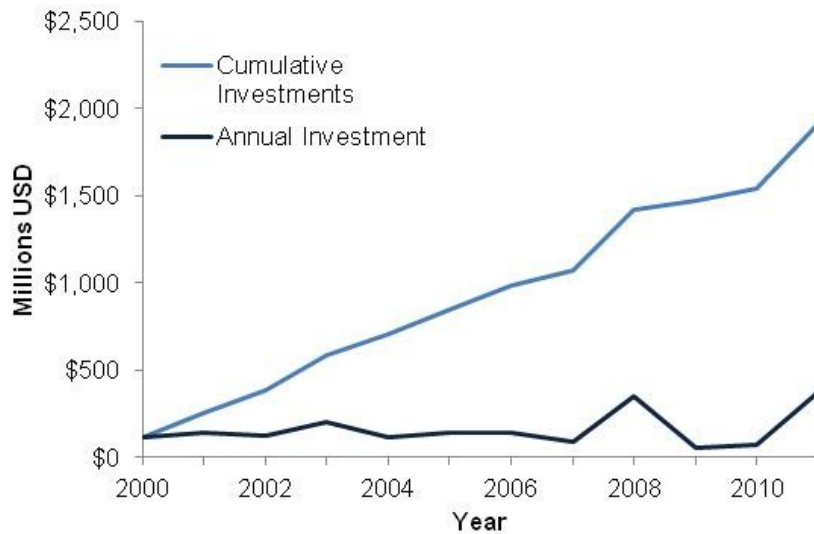


Figure 6.  
Panama Canal  
Authority  
capital  
investment

Twenty-one year-old Pérez, whose office overlooks the Miraflores locks, started at the canal in 1978 as a mechanic’s apprentice. His current job is arguably the least romantic, but most important, at the authority: keeping century-old infrastructure in working condition. It is also the area where most observers expected Panama to fall down on the job. Sweeping judgments about cultural attributes are always perilous. Even Pérez, however, concedes that Panama lacks a maintenance culture. Most of the country’s buildings went up less than two decades ago, he said. Maintenance jobs lack prestige. Nevertheless, the Panama Canal Authority has a maternal attitude toward its equipment and infrastructure. Instead of “fixed time” repairs – replacing a part automatically after a predetermined period of use – canal engineers conduct periodic reviews to identify

<sup>259</sup> Interview by author with Abdiel Pérez, August 23, 2013, Panama City, Panama.

problems in advance; the “predictive maintenance” model often involves the analysis of samples in a laboratory to determine when maintenance is required. That is no small task for an operation with ancient equipment, that accommodate 14,000 ships a year and run 24 hours a day.<sup>260</sup> The authority spends tens of millions of dollars annually keeping up its three dams; maintaining lock gates and lock locomotives; and keeping its tugboats, launches, cranes and dredges operational. In 2001, for example, total maintenance spending hit \$175 million, including \$58 million alone on the three sets of locks. As a result, delays at the locks have fallen from 10,000 minutes per year in the 1990s to fewer than 1,000. (Yes, they measure that, too.) In 2013, the authority hosted a conference on its maintenance policies – the First International Maintenance Congress – where it boasted of its record to 400 participants and a panel of 12 foreign experts.

Panamanians are not the only ones benefiting from the authority’s success. Despite a relentless increase in the size of cargo ships – and associated increases in navigational challenges – vessels are navigating the canal at ever greater speeds. In 2000, a journey through the canal lasted 29.4 hours on average. In 2013, the Canal Waters Time – a measure that includes waiting time outside the canal – was only 24.5 hours. Over that period, Canal Waters Time fell by 17 percent, though the improvements were inconsistent (Figure 7).

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<sup>260</sup> The Panama Canal has been an all-day affair since 1967, when fluorescent lights flickered on for the first time in the Culebra Cut and at the locks.

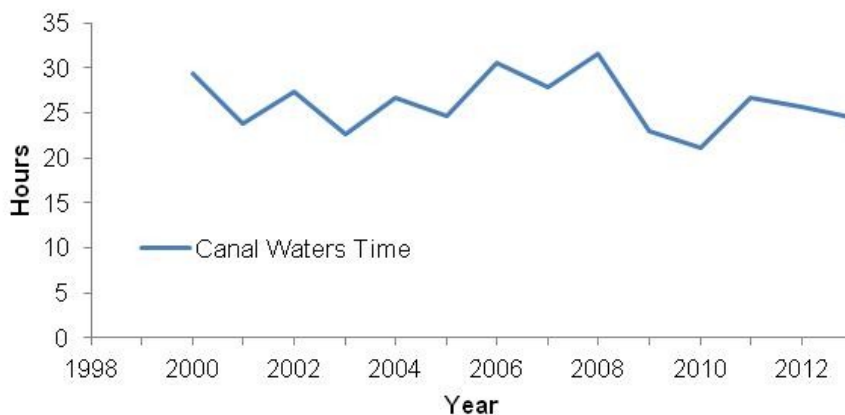


Figure 7. Canal Waters Time

The Panama Canal Authority has resisted pressure to lard its payroll with politically connected Panamanians. Still, is it not a particularly lean operation. After trumpeting a ruthless, profit-driven attitude to replace the supposedly lumbering U.S. bureaucracy, the authority did not exactly downsize. In its first decade, the number of employees dropped only twice. In 2013, it hit 10,098, up from 9,157 in 2000, a 10 percent increase (Figure 8). Payroll is no small matter; in the 2013 fiscal year, the canal authority paid \$389.8 million in salaries.<sup>261</sup> That year, personnel services and employee benefits accounted for 67 percent of total expenses. (The next biggest expense, fuel, consumes about 10 percent of the budget.) From 2000 to 2009, over all annual

spending rose from \$427 million to \$535 million, an increase of 25.3 percent.<sup>262</sup>

<sup>261</sup> Panama Canal Authority, Annual Report, 2013.

<sup>262</sup> Suárez 2010, p. 81.



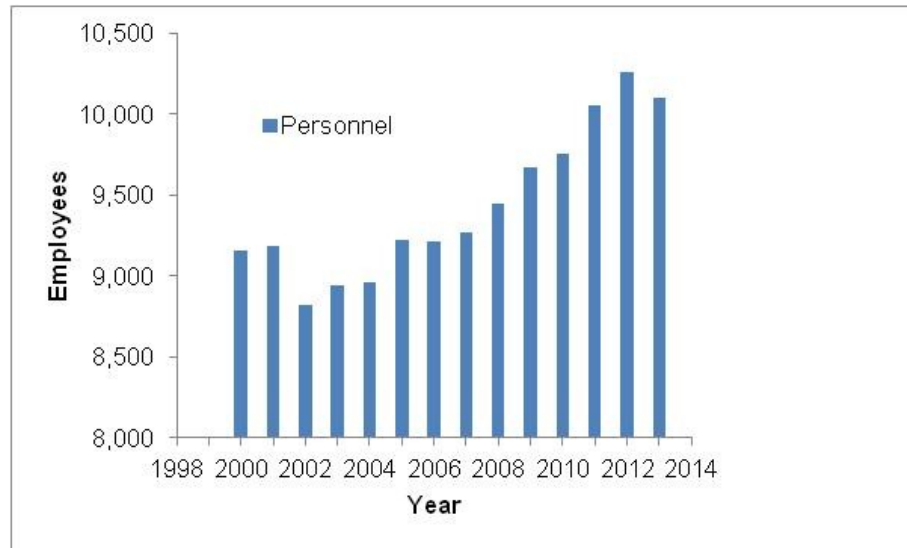


Figure 8.  
Panama Canal  
Authority  
workforce

## Discontent

As was inevitable, praise for the canal authority has not been universal, especially among its unionized workforce. Disgruntled employees have marched to the Panamanian legislature in protest, filling the gallery as union leaders lashed out against the canal authority's leadership, the non-renewal of contracts for manual laborers and a supposed diversion of maintenance funds to the canal expansion. In August 2013, as tensions flared, canal unions published a scathing, nine-page, color magazine titled, "Trabajador Canalero, La Maravilla Olvidada" ("Canal Worker, the Forgotten Miracle"). Styled after the canal's official "Tu Canal" newsletter, it carried the ominous headline, "The Panama Canal, What They Don't Want You to Know." The editor's note set the tone; it condemned the canal authority's "authoritarian" labor code, and warned that Panama's infamous "fifth border" had persisted beyond the U.S. exodus.<sup>263</sup> The list of grievances

<sup>263</sup> "¿Quiere la Administración de la Autoridad del Canal de Panamá Mantener la Quinta Frontera?" *Trabajador Canalero, La Maravilla Olvidada*, August 2013.

was long and sundry: a “highly unfavorable labor climate” put canal operations at risk<sup>264</sup>; the four Canadian-built, Z-Tech 6000 tugboats the authority purchased were a “true nightmare,” polluting and dangerous for their crews;<sup>265</sup> the eight Chinese-built tugboats the authority purchased were no better, poorly designed and assembled;<sup>266</sup> and the authority squandered \$1 million renovating the residences of the administrator and his deputies.<sup>267</sup> “They have totally lost the vision that made this canal a wonder of the world,” the unions warned. Instead, the canal authority had developed “an oppressive administration of its workforce that sooner or later would destroy the canal.”<sup>268</sup>

“Since the transfer of the canal, much of the Panama Canal Authority’s effort has involved media spectacles and a flood of praise for executives, but scant acknowledgement of the workers who, far from the comfortable, air conditioned offices, make the canal operation’s success possible. These employees labor day and night, under the hot sun and the rain, armed only with their commitment to the Panama Canal.”<sup>269</sup>

In 2012, 6,000 workers assigned to the canal expansion went on strike to demand higher wages, claiming that the consortium expanding the canal had failed to pay overtime and alleging a lack of workplace safety.<sup>270</sup> In 2014, the International Transport Workers’ Federation alleged that the Panama Canal Authority had engaged in union busting when it attempted to shut down the tugboat captains union.<sup>271</sup> Nevertheless, canal

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<sup>264</sup> “Remolcadores, La Verdadera Piedra Angular de Nuestro Canal,” *Trabajador Canaleiro, La Maravilla Olvidada*, August 2013, p. 1.

<sup>265</sup> *Ibid.*, p. 3.

<sup>266</sup> “¿Estará la Visión del Canal, a Sus 99 Años de Construcción, Borrosa?” *Trabajador Canaleiro, La Maravilla Olvidada*, August 2013, p. 5.

<sup>267</sup> *Ibid.*, p. 7.

<sup>268</sup> “Remolcadores, La Verdadera Piedra Angular de Nuestro Canal,” p. 3.

<sup>269</sup> “Ampliación y Contradicción,” *Trabajador Canaleiro, La Maravilla Olvidada*, August 2013, p. 8.

<sup>270</sup> “Panama Canal Workers Strike for Higher Wages,” *Latin America Advisor*, January 18, 2012.

<sup>271</sup> Miller, Greg, “Panama Faces New Labor Accusations,” *HS Maritime 360*, November, 24, 2014.

workers appear to be generally satisfied, or at least satisfied enough to stick around.

Turnover in 2012 was less than 2 percent.<sup>272</sup>

### **Local Audience**

Recent labor complaints have failed to color public opinion about the Panama Canal Authority's record. Back in 2000, however, the Panamanian public was generally unimpressed with the canal authority. In fact, arguably no one has been more surprised by Panama's success than Panamanians themselves. Leading up to the transfer of the canal, many Panamanians did not feel up to the task. A famous political cartoon imagined a *diablo rojo* – the colorful, provocatively painted, privately operated city buses that symbolized urban chaos in Panama City – floating through a canal lock. That is not to say that the turnover of the canal was unpopular. Far from it. On the day of the transfer, December 31, 1999, thousands of Panamanians climbed rain-soaked Ancón Hill for the ceremony, “a momentous, solemn event that would remain indelibly impressed on the minds of the Panamanian people.”<sup>273</sup> The crowd spilled onto the 113 marble steps that lead to the historic canal Administration Building from the marble Goethals memorial. Yet at the time, 42 percent of Panamanians thought Panama was incapable of running the canal, with 17 percent fearing a deterioration in maintenance.<sup>274</sup>

Gradually, however, the authority won over its countrymen. By 2001, 64 percent of Panamanians were optimistic about the canal's future.<sup>275</sup> In 2006, 80 percent of Panamanians expressed pride in the canal. These changes in public opinion reflect, at least in part, the canal authority's dogged commitment to marketing. Few Panamanians

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<sup>272</sup> Panama Canal Authority, Annual Report, 2013.

<sup>273</sup> Panama Canal Authority, Annual Report, 2000.

<sup>274</sup> January 2000 national survey by CID Gallup.

<sup>275</sup> February 2001 national survey by CID Gallup.

have direct contact with the canal. Nevertheless, the authority bends over backwards to impress locals. It built visitor centers “so all Panamanians could admire the patrimony that they had been deprived of for so many years.”<sup>276</sup> It offers paid internships for college students – including 445 in the 2003 fiscal year alone<sup>277</sup> – and signed an agreement with the University of Panama to facilitate academic exchanges. It holds an annual charity drive, channeling employee donations to dozens of causes. It sends emissaries to local schools to preach about the canal’s importance, distribute promotional materials and a teacher’s handbook, and donate books. It woos history and geography teachers.<sup>278</sup> It sponsors opera performances. In 2007, it began publishing a monthly magazine, “El Faro,” inserting 100,000 copies into the newspapers La Prensa and Critica.<sup>279</sup> The next year, it launched a TV program, “Tu Canal al Día.” Its “Tu Canal” in-house newsletter advertises canal merchandise, including mugs and key chains. For the canal’s centennial, in 2014, the Miraflores Visitors Center hosted “Magical Nights at the Panama Canal” featuring fireworks, live music and dancing and costumed characters portraying the failed French canal builder Ferdinand de Lesseps and George Washington Goethals, the U.S. engineer who successfully completed the canal. On August 15, 2014 – exactly 100 years after the SS Ancon inaugurated the Panama Canal – the Panama Canal Authority served a 500-pound cake in the shape of a canal lock and hosted a televised centennial gala with Panamanian singer Rúben Blades and a team of acrobats performing.<sup>280</sup>

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<sup>276</sup> Alberto Alemán Zubieta, “The Story That Panama Decided to Write, The Panama Canal through the Years,” *ReVista*, Spring 2013.

<sup>277</sup> Panama Canal Authority, Annual Report, 2003.

<sup>278</sup> In the 2003 fiscal year, for example, 83 percent of Panama’s geography and history teachers participated in the canal authority’s “Everyone’s Canal” program.

<sup>279</sup> The magazine was originally titled “The Spillway.”

<sup>280</sup> Suri, Charu, “Celebrating the Centennial of the Panama Canal,” *The New York Times*, August 6, 2014.

The Panama Canal Authority is a relentlessly self-promoting operation, favors grandiose prose and fixates on its role in history. It has called the canal's "seamless transfer" to Panamanian control the singular development since the canal's opening.<sup>281</sup> Reflecting on the 2001 fiscal year, before Panama had a full 12 months of canal management under its belt, the chairman of the canal authority board, Ricardo Martinelli, a future president of Panama, declared victory. "From the moment we assumed full responsibility for canal operations, we have demonstrated to the world that we are indeed highly capable of managing an enterprise of this magnitude," he said.<sup>282</sup> To mark a decade of Panamanian ownership, the authority published a 302-page, hard cover volume celebrating its achievements. "This book is dedicated to each and every Panamanian," the canal administrator at the time, Alberto Alemán Zubieta, wrote in the prologue, "because the Panama Canal lives in each of us."

The Panama Canal Authority's annual reports are purposefully characterized by the same overwrought prose and corporate cheerleading. "With unrelenting will, we labor to operate, maintain and improve the Panama Canal," the 2005 report announced. In 2007, it summed up its management as "spotless." In 2008, it nominated itself as "a model of excellence, integrity and transparency." Though hard-nosed and profit-driven, the company is also prone to philosophical musings. In 2009, it said "destiny has allowed us to fulfill the dreams of the generations of Panamanians that fought to recover our most strategic resource." It returned to that theme in 2010 – the year the canal saw its 1 millionth transit<sup>283</sup> – calling the canal's success "an unmistakable demonstration of how

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<sup>281</sup> Panama Canal Authority, Annual Report, 2000.

<sup>282</sup> Ibid.

<sup>283</sup> The 1 millionth transit occurred on September 4, 2010, when the bulk carrier Fortune Plum crossed the canal.

much a nation can do when it faces its destiny with determination.” In 2013, the report was even more effusive. The canal was “one of the wonders of the world”; Panama was “helmsman of a first world company”; and the canal authority had “built a faultless management model of excellence, integrity and transparency.” The result? “An impeccable reputation and image, which is an object of national and international respect, admiration and recognition.”

### **Vote of Confidence**

In 2006, all those efforts to win friends and influence Panamanians were put to the test. The authority had decided to widen the canal and according to Panama’s constitution,<sup>284</sup> that required a national referendum. President Martín Torrijos (2004 to 2009) formally announced the referendum at the Atlapa convention center in Panama City on April 24, 2006. On its face, the proposal should not have been controversial. Canal authorities had studied the project for decades. (In fact, the United States began excavation for a wider canal in the 1930s, to accommodate large Navy ships, but the outbreak of World War Two interrupted the project.) In the 1980s, a joint study by the United States, Japan and Panama warned that the canal was already approaching its maximum capacity. A class of container ships too wide for the canal locks – limited to ships no longer than 964 feet, deeper than 39 feet or wider than 105 feet – was increasing in popularity. In 1989, Saul Bellow described one of his characters as so large, “she made you look twice at a doorway. When she came to it, she filled the space like a freighter in

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<sup>284</sup> Article 325 of Panama’s constitution required legislative and public approval for the construction of a sea-level canal or the addition of a third set of locks, <http://pdba.georgetown.edu/Constitutions/Panama/vigente.pdf>.

a canal lock.”<sup>285</sup> By 2005, some container ships were twice the Panama Canal limit, and oil tankers were five times as large.<sup>286</sup> Vessels from Asia that were excluded from the Panama Canal sailed around the southern tip of South America, adding 21 days to their trip to the U.S. East Coast, and raising costs tenfold.<sup>287</sup> In Egypt, the rival Suez Canal, a sea-level maritime shortcut, could already accommodate these behemoths. Additionally, an expanded Panama Canal would accommodate liquefied natural gas carriers for the first time, a potentially lucrative market, given Japan’s interest in Gulf Coast natural gas.<sup>288</sup> Meanwhile, there was hardly space for the ships that could still fit in Panama’s canal. Increasing trade to the U.S. East Coast and Europe from manufacturers in Japan, South Korea, Taiwan and China was overwhelming the canal.<sup>289</sup> If maintenance or malfunction shut down a lane of service temporarily, as many as 100 vessels ended up bobbing in the sea for days awaiting transit.<sup>290</sup> “The canal’s expansion,” concluded LatinFinance at the time, “is becoming urgent.”<sup>291</sup> The World Shipping Council, in a report before the referendum, agreed:

“The preferred route for the cargo moving between North Asia and the U.S. East Coast and Gulf is that via the Panama Canal, due to the shorter transit and the ability to use fewer vessels when compared with the Suez route. But without expansion of its capacity to handle more vessels and larger vessels, the Panama Canal will become an increasingly less viable and competitive option to maintain its essential position as one of the world’s great trade gateways. The Panama Canal Authority’s proposed plan for expansion is based on a sound and well-reasoned analysis of both the future market demands of world trade and what Panama needs to do to maintain its role in the world economy.”

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<sup>285</sup> Saul Bellow, *The Bellarosa Connection* (New York City, N.Y.: Penguin Books, 1989).

<sup>286</sup> “Tight squeeze, The Panama Canal,” *The Economist*, July 23, 2005.

<sup>287</sup> Fittipaldi, Santiago, “Tomorrow’s Canal,” *LatinFinance*, February 2005.

<sup>288</sup> Iwata, Mari and Molinski, Dan, “Japan Protests Planned Limits on Panama Canal Ships, Tokyo Says Rules Could Restrict U.S. Gas Supplies to Asia,” *The Wall Street Journal*, April 23, 2014.

<sup>289</sup> Lapper, Richard, “A Post-Panamax Renaissance,” *The Financial Times*, July 24, 2007.

<sup>290</sup> Tirschwell, Peter, “Straight talk on the Panama Canal,” *Journal of Commerce*, October 30, 2006.

<sup>291</sup> “Make Way!,” *LatinFinance*, March 2006.

The expansion, according to its boosters, was expected to create 7,000 direct jobs,<sup>292</sup> and produce 40,000 new jobs over all, taking into account indirect impacts<sup>293</sup> such as massive spending on local cement to build the new locks and on housing for local and foreign construction workers. The project also promised to protect the Panama trade routes; enrich local port managers, insurers and shipping and freight companies; quadruple the canal authority's annual contributions to Panama's treasury;<sup>294</sup> and during construction, add 1 percent annually to Panama's GDP growth.<sup>295</sup> The canal authority said its recruiters would hunt for a diverse army of new personnel, including dredge operators, oilers, open-air blasting experts, drill equipment operators, launch operators, budget analysts, masons, fitters, carpenters, blast handlers, welders, electricians, surveyors, engineers, programmers and seasoned operators of excavators, tractors, cranes and drills.<sup>296</sup> After construction, the expanded canal would require a permanently expanded workforce, staffed by newly hired pilots and tugboat captains, pipefitters, shipfitters and metal forgers, blasters, dredge operators and locomotive drivers.

The Panama Canal Authority mused about the expansion from the moment it inherited the waterway. In 2001, it announced "pre-feasibility studies" for a potential expansion.<sup>297</sup> (In all, it would spend \$40 million<sup>298</sup> on more than 130 studies addressing

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<sup>292</sup> Jaime Alemán, "How Important Is the Canal's Expansion for Panama?," *Latin America Advisor*, April 12, 2010.

<sup>293</sup> Guillermo Chapman, "How Important Is the Canal's Expansion for Panama?," *Latin America Advisor*, April 12, 2010.

<sup>294</sup> Jaime Alemán, "What Would an Investment Grade Rating Mean for Panama?," *Latin America Advisor*, February 19, 2010.

<sup>295</sup> Chapman 2010.

<sup>296</sup> Panama Canal Authority, Annual Report, 2006.

<sup>297</sup> Panama Canal Authority, Annual Report, 2001.

<sup>298</sup> Whitefield, Mimi, "Panama Canal's \$5 billion Makeover Could be Boon for South Florida," *The Miami Herald*, November 17, 2012.



the expansion.<sup>299</sup>) In 2002, the proposed expansion “commanded priority status”<sup>300</sup> at the authority. Canal expansion supporters said the waterway, “once a modern, multilane highway,” had become “an old, congested country road.”<sup>301</sup> To reanimate the infrastructure, the expansion would double canal capacity by adding a third lane of locks; dredging the canal access channels on the Atlantic and Pacific sides; expanding and deepening existing navigation channels; and increasing the maximum functioning level of Gatún Lake, which provides the fresh water for filling the locks to lift and lower ships. In a visit in 2005, President George W. Bush stopped by the Miraflores locks, let pass a ship carrying Chilean lumber to Mexico and unequivocally endorsed the expansion.<sup>302</sup> “It’s in our nation’s interest that this canal be modernized,” he said. To Panama’s government, the project had built up an air of historic inevitability. President Martín Torrijos was the son of former Panamanian strongman Omar Torrijos, whose negotiators wrested the canal from U.S. hands. Martín Torrijos’s vice president, Samuel Lewis Navarro, was the son of Gabriel Lewis Galindo, Omar Torrijos’s famed ambassador to the United States during the treaty negotiations. “It was time to pass the baton to the next generation, and make sure we didn’t mess it up,” Samuel Lewis Navarro said. “When our turn came, we stepped up to the plate.”<sup>303</sup>

The Panamanian public saw things differently. The canal authority likes to describe Panamanians as the canal’s “owners and sole shareholders.”<sup>304</sup> At the time, however, the canal authority was widely regarded as insular, elitist and secretive, despite

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<sup>299</sup> Nicolás Ardito-Barletta, *Latin America Advisor*, November 11, 2005.

<sup>300</sup> Panama Canal Authority, Annual Report, 2002.

<sup>301</sup> Lacey, Marc, “Upgrade the Canal? Many Panamanians Are Saying No,” *The New York Times*, September 3, 2006.

<sup>302</sup> Bumiller, Elisabeth, “Bush, Meeting Panama’s Leader, Endorses Widening of the Canal,” *The New York Times*, November 8, 2005.

<sup>303</sup> Interview by author with Samuel Lewis Navarro, August 21, 2013, Panama City, Panama.

<sup>304</sup> Panama Canal Authority, Annual Report, 2001.

its relentless public outreach. Some derided the canal as a “colony,” and its administrator as an “emperor.” (To this day, Panama City taxi drivers complain they do not know their way around the neighborhoods bordering the canal.) Nor was the referendum merely a popularity contest for the canal authority. Panama had come to depend upon canal dividends, and the complex and costly expansion project, if mismanaged, could imperil the whole enterprise. Critics wrangled over the future distribution of the additional earnings an expanded canal might generate. Others raised environmental concerns;<sup>305</sup> the project would require bulldozing 583 acres of forest, 203 acres of shrubbery and 707 acres of grasslands,<sup>306</sup> and the relocation of anteaters, squirrel and howler monkeys, crocodiles and snakes. (To reassure conservationists, project planners promised that construction would not cause the total extinction of any local fauna.) Homeowners, farmers and fans of the four national parks near the canal feared displacement.<sup>307</sup> Engineers and economists forecast construction cost overruns and a crushing debt hangover, complaining that Panama was “risking its most important asset on dubious engineering and financial assumptions.”<sup>308</sup>

Nor did everyone accept the canal’s promises of broader economic impacts in the short- and long-term. The canal is not only culturally isolated from Panama, it also stands economically apart in many ways. Repeated attempts to strengthen economic linkages have yielded only modest success. The canal, for example, directly accounts for only 0.5

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<sup>305</sup> Dudley, Steven, “Panama Will Decide Whether to Expand Canal to Accommodate Oversized Ships,” *The Miami Herald*, March 22, 2005.

<sup>306</sup> Panama Canal Authority, Annual Report, 2006.

<sup>307</sup> Dudley March 22, 2005.

<sup>308</sup> Kraul, Chris, “Panama to Vote on Canal Expansion, The \$5.2-Billion Project is Expected to Pass. Critics Find Their Voices Drowned Out by the Government Campaign,” *Los Angeles Times*, October 22, 2006.

percent of jobs in Panama.<sup>309</sup> Its activities offer limited benefit to Panama's chronically struggling, domestically oriented economic actors, such as its indigenous communities and legions of poor farmers. (Agriculture is Panama's number-one employer outside Panama City.) As for the expansion, the flood of public spending would no doubt provide the economy short-term tailwinds, adding to a geyser of public infrastructure spending. (In addition to the canal expansion, Panamanian construction crews would also be busy digging the country's first subway, part of a \$14 billion investment plan Martinelli announced upon taking office.<sup>310</sup>) However, some economists argued that the canal expansion's forecasted contributions – the so-called “multiplier effects” – would be largely limited to the construction sector and producers, mainly overseas, of capital goods. (Others disagreed, pointing to the likely positive impacts on the Colón Free Trade Zone on the Atlantic side of the canal.<sup>311</sup>) Following the expansion, it remained to be seen whether over all traffic or tonnage would dramatically expand. To some degree, the expansion would be a defensive maneuver, designed merely to *preserve market share*, keeping Panama Canal customers from Suez and the U.S. intermodal system that connects U.S. West Coast ports with U.S. East Coast markets.<sup>312</sup> (Panama Canal capacity would indisputably increase, to 50 to 55 vessels per day, from 36 to 40.<sup>313</sup>)

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<sup>309</sup> Maurizio Bussolo, Rafael E. De Hoyos and Denis Medvedev, “Distributional Effects of the Panama Canal Expansion,” *Economia* Vol. 13, No. 1 (2012): p. 80.

<sup>310</sup> Crowe, Darcy, “Panama's Economy to Extend Strong Growth in 2013,” *The Wall Street Journal*, March 16, 2013.

<sup>311</sup> Anthony M. Pagano, Miles K. Light, Onésimo V. Sánchez, Ricardo Ungo and Eddie Tapiero, “Impact of the Panama Canal Expansion on the Panamanian Economy,” *Maritime Policy & Management* Vol. 39, No. 7 (2012), p. 712.

<sup>312</sup> James T. Edmonds, “Panama Canal ‘Game Change’ Depends on Who Provides the Best ‘Playing Fields,’” *Economic Development Journal* Vol. 11, No. 2 (2012), p. 43.

<sup>313</sup> Uccelli, Franco A. “Panama: Canal Toll Revenues Climb 3 percent in January-August,” *J.P. Morgan Latin America Emerging Market Research*, September 13, 2013.

The specter of overindebtedness loomed large, even after the authority pledged to finance the expansion through its own revenues, not Panamanian sovereign bonds. Interest on the debt needed for the expansion, critics argued, would overwhelm any revenue gains.<sup>314</sup> Fernando Manfredo, a former acting canal administrator, questioned the authority's cost and revenue estimates.<sup>315</sup> "The feasibility of this proposal," one analyst observed, "remains to be demonstrated and, at best, would mean the central government forgoing the important financial contributions the canal revenues make to Panama's budget."<sup>316</sup>

For many in Panama, the vote was also a referendum on the canal authority itself. Had tiny Panama's state-owned enterprise demonstrated the skill, grit and integrity to tackle a \$5 billion megaproject? Six years into Panama's canal administration, government and canal officials were surprised *Petróleo Brasileiro* by the lingering doubt. Dogged by questions about rampant corruption in Panama's central government and its implications for canal project management, Torrijos grew frustrated. "It's like if I said that all men cheat on women," he explained. "Some of them do, but not all."<sup>317</sup> It was a colorful metaphor, but it apparently did little to ease concerns over Panama's "notorious reputation for brazen malfeasance."<sup>318</sup> ("The expansion is necessary, but we all have to watch closely, make sure there isn't embezzlement and corruption," a Panamanian advertising executive, Igor Meneses, told *The New York Times* on the day of the

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<sup>314</sup> Adrian Cruz, *Latin America Advisor*, April 27, 2006.

<sup>315</sup> Tim Padgett and Michele Labrut, "New Path to Progress: Panama Will likely Opt to Widen its Canal. The Goal? A Central American Hong Kong," *Time*, November 6, 2006.

<sup>316</sup> Robb Suchecki, *Latin America Advisor*, November 7, 2005.

<sup>317</sup> Lacey 2006.

<sup>318</sup> Padgett 2006.

referendum. “With that kind of money, there’s a lot to steal.”<sup>319</sup>) “The past,” Torrijos acknowledged, “is haunting our future. It’s a weight on this referendum.” The vote was repeatedly delayed, in part out of fears of a potentially negative outcome.<sup>320</sup> Torrijos himself was unpopular, and “Panamanians tend to take any referendum on any subject as an opportunity to express their displeasure with the government.”<sup>321</sup> Election authorities had registered 267 interest groups taking sides in the referendum campaign, including 66 in opposition, powered by intellectuals, leftist organizations and former President Jorge Illueca.<sup>322</sup> In July 2006, the legislature approved the expansion. The next month, three months before the vote, only half of Panamanians said they supported the project. In September 2006, with a month to go, the outcome remained too close to call. In one poll, a quarter of opponents said they lacked confidence in Panama’s ability to administer the expansion.<sup>323</sup> “It’s something that should unite our country,” lamented Juan Carlos Varela, then an opposition politician and later Panama’s president.<sup>324</sup> “Instead, it’s dividing us.”<sup>325</sup>

For the first time, the canal’s stodgy engineers and technicians had to romance the Panamanian public. The mobilization looked like a presidential campaign. The authority assigned 60 individuals to promote the canal expansion; deployed a bus screening promotional videos; participated in 100 public debates; answered 21,268 phone calls to

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<sup>319</sup> Lacey, Marc, “Panamanians Vote Overwhelmingly to Expand Canal,” *The New York Times*, October 23, 2006.

<sup>320</sup> “The Americas: The Voters and the Ships, The Panama Canal,” *The Economist*, October 21, 2006.

<sup>321</sup> Eric Jackson, *Latin America Advisor*, November 7, 2005.

<sup>322</sup> Suárez 2010, p. 259.

<sup>323</sup> Dudley, Steven, “A New Divide over the Panama Canal,” *The Miami Herald*, October 20, 2006.

<sup>324</sup> At the time of the canal expansion referendum, Juan Carlos Varela was president of the Panameñista Party. He won the presidency on May 4, 2014.

<sup>325</sup> Padgett 2006.

an authority hotline; and attracted 34,500 visitors to 16 information centers<sup>326</sup> in nine provinces.<sup>327</sup> Canal representatives barnstormed the isthmus, traveling to the northern San Blas islands in the Caribbean, home to isolated Kuna Indians; to the rainforested Darién on the Colombian border to the east, where The Lonely Planet’s “Dangers & Annoyances” advisory warns of kidnappings, narcotraffickers and Colombian guerrillas; and to the Bocas del Toro archipelago by Panama’s western border with Costa Rica, a hippy vacation hub originally built by the United Fruit Company. “We weren’t used to that, we had to hit the streets,” Eduardo Antonio Quirós, who served on the canal board of directors for nine years, recalled.<sup>328</sup> Buttoned-up, boardroom dwelling senior canal officials also fanned out. Quirós journeyed 160 miles outside Panama City to the Hotel Piramidal, in Santiago, in central Panama. Five hundred people had gathered for his presentation on the expansion and afterward, they interrogated him for three hours about the project. It was clear the authority’s leadership, performance and institutional design were under a microscope. “It was a great opportunity for the country to approve the model,” he said. (The government helped, too. Torrijos and Lewis, his vice president, campaigned hard for the referendum, promising to funnel proceeds from the expansion to local governments to fund projects selected at community meetings.<sup>329</sup>

Ultimately, the authority made five important concessions to rescue the project:

1. It set a minimum for the annual dividend it pays the Panamanian treasury, eliminating the downside risk for the country; regardless of construction costs and future debt service, the authority’s annual surplus payment would not fall below the level in the 2005 fiscal year;
2. It altered construction plans to exclude new reservoirs that would have displaced communities;

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<sup>326</sup> Suárez 2010, p. 259.

<sup>327</sup> Panama Canal Authority, Annual Report, 2006.

<sup>328</sup> Interview by author with Eduardo Antonio Quirós, August 8, 2013, Panama City, Panama.

<sup>329</sup> Interview by author with Samuel Lewis Navarro, August 21, 2013.

3. It promised to build a new bridge for cars to cross the canal at its economically depressed Atlantic side;
4. It committed to providing quarterly written updates on the project to the president, legislature and the nominally independent comptroller's office, and to submitting the canal administrator and the chairman of the authority's Board of Directors to semiannual congressional hearings; and,
5. It agreed to oversight from a seven-member ad hoc committee comprising representatives from the National Council for Organized Labor (CONATO); the National Council for the Private Enterprise (CONEP); Panama's civic clubs; the University Presidents Council; the Ecumenical Committee; and representatives designated by the legislature and the president.

On October 22, 2006, Panamanians finally weighed in. Voters faced a single question: "Do you approve of the proposal for the construction of a third set of locks for the Panama Canal?" Polls remained open from 7 a.m. to 4 p.m. By day's end, the authority had earned an impressive vote of confidence. The referendum passed easily, backed by 78 percent of voters. Only 44 percent of registered voters participated in the referendum, but that seemed to reflect the widespread belief that the authority had already won the debate. Torrijos called it an "historic decision, perhaps the most important of this generation." Curators of the Miraflores Visitors Center, overlooking the Miraflores locks, encased in glass the referendum ballots, green for "Sí," red for "No." Aléman, the Panama Canal chief operation officer, was considered a future presidential candidate.

### **Hat in Hand**

The referendum was not the only vote of confidence the Panama Canal Authority needed for the megaproject to advance. Someone had to pay for it. So the canal authority launched a road show, subjecting itself to global investor scrutiny for the first time. Because the authority had never issued debt, it was not tracked closely by the major investment banks. Sovereign debt analysts monitored canal revenues, given their

importance to the Panamanian budget and economy. In the world's major financial centers, however, the canal had mostly flown under the radar. In that context, the authority had its global debut in 2007, when canal executives made presentations on the expansion in New York City, London and Hong Kong, meeting with 160 financial institutions.<sup>330</sup> The presentations – to First Union Bank, Citibank, Credit Suisse, Barclays, Societe Generale and others – emphasized the Panama Canal Authority's "complete independence from the central government" and the prohibition against strikes by canal workers.<sup>331</sup> New to capital markets, the authority asked Moody's to evaluate it for the first time. On September 10, 2008, Moody's awarded the authority a Prospective (P) A2 rating.<sup>332</sup> The rating was monumental for several reasons. For one, it was substantially higher than the Panamanian government's own Ba1 non-investment grade rating at the time.<sup>333</sup> Additionally, Moody's issued the rating amid a global financial crisis<sup>334</sup> that threatened to reduce canal traffic, and only three days after the Federal Housing Finance Agency had placed Fannie Mae and Freddie Mac in government conservatorship and only five days before the Lehman Brothers bankruptcy and Bank of America's rescue of Merrill Lynch.<sup>335</sup> On a scale of 1 to 21, with 1 representing the lowest credit risk, Moody's gave the authority a "5." In evaluating the authority, Moody's weighed heavily

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<sup>330</sup> Omar Jaén Suárez, *Diez Años de Administración Panameña del Canal* (Panama City, Panama: Panama Canal Authority, 2010), p. 262.

<sup>331</sup> Panama Canal Authority, confidential presentation on proposed canal expansion, October 2000.

<sup>332</sup> Hu, Chee Mee, "Moody's Assigns a Prospective (P) A2 Rating to the Senior Unsecured Debt Obligations of the Panama Canal Authority in Conjunction with the Expansion Project. The (P) A2 Rating Pierces the Current Country Ceiling of A3 by One Rating Notch," Moody's Investors Service, September 10, 2008.

<sup>333</sup> The Panamanian government's Ba1 rating was four rungs (Baa3, Baa2, Baa1 and A3) below the Panama Canal Authority's A2 rating on Moody's rating scale, which indicates gradations of creditworthiness. Baa3 is the lowest investment grade rating.

<sup>334</sup> Joaquín Jácome, "How Will Global Economic Troubles Affect the Panama Canal?," *Latin America Advisor*, October 28, 2008.

<sup>335</sup> Federal Reserve Bank of St. Louis, "The Financial Crisis, Full Timeline," accessed February 22, 2015, <https://www.stlouisfed.org/financial-crisis/full-timeline>.



the uniqueness of its service and the high barriers to entry. The Panama Canal, it concluded, “is a unique infrastructure asset that is competitive and unlikely to be replicated.” In its “unique market,” it said, “the canal enjoys an exceptionally strong operating position.” Moody’s also looked carefully at the authority’s financial performance since the turnover.

“The canal has been operating as an independent asset of the Panamanian government since 2000, hence there is sufficient operating history against which to assess the [authority’s] business model and to analyze future projections. The [authority] has successfully navigated the transition from U.S. management to operation as a wholly-owned enterprise of the Government of Panama,” Moody’s said.

Still, as a borrower, the Panama Canal Authority was somewhat risky. The authority would rely on a single asset to generate the earnings to service its multibillion dollar debt. Moreover, the loan for the expansion would be *completely unsecured*; Article 45 of the canal authority’s organic law, approved on June 11, 1997, prohibits the use of canal revenue or assets as collateral.<sup>336</sup> For its part, the Panamanian government offered no guarantees for the loan. This contrasted with more traditional limited recourse project finance. For example, a lender financing a bridge construction typically ends up owning the bridge if the borrower defaults. (Either way, repossessing the Panama Canal would not be easy, even for litigious Wall Street creditors like Elliot Management.) Finally, the terms of these loans would deprive lenders of any role in canal management; offer a 20-year maturity; and grant the authority a ten-year grace period.

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<sup>336</sup> Organic Law, Article 45: “The national government may not commit the gross revenues received by or through the authority, or offer any property from its patrimony as collateral for loans or any financial transaction of the state or by any of its autonomous agencies. Also, the national government may not charge, on its own, any expense against future canal revenues,” <http://www.pancanal.com/eng/legal/law/law.pdf>.

In other ways, however, the expansion project was attractive to lenders. Unlike with traditional infrastructure finance, the canal authority would be generating revenue throughout the construction phase. The loan was attractive for other reasons as well:

1. The canal operated behind a “moat,” i.e., it faced limited competition, and the canal authority (literally) relied upon “tolls,” i.e., reliable, repeating revenues, for all of its income;
2. The canal authority’s lightly levered construction financing plan was relatively conservative, with the \$5.25 billion project relying upon only \$2.3 billion in borrowing, far below the common 75 percent debt-to-25 percent equity ratio in infrastructure finance;
3. The canal authority had zero debt on its books (previously, it had only used current revenues and ordinary course reserves for capital needs);
4. The canal authority was required to pay a minimum annual dividend to Panama’s central government, effectively restricting any future borrowing that could result in an unsustainable debt burden;<sup>337</sup> and,
5. The canal authority faced no currency risk, as canal revenues are in U.S. dollars, the denomination of its proposed loans.

There was also the authority’s proven business model and corporate organization, and its demonstrated success over seven years. As a result, among investors, the interest was “tremendous,” recalled Franco Uccelli, a senior analyst at J.P. Morgan.<sup>338</sup> In 2007, he attended the Inter-American Development Bank’s annual meeting in Guatemala City,<sup>339</sup> where a senior canal authority official delivered a presentation on the expansion. It was standing room only and “all the market participants were salivating,” Uccelli said.

By the time Panamanians approved the referendum, lenders had been tracking the potential megaproject for a decade. The Panama Canal Authority “was this great asset, this great corporation with no debt,” Uccelli said. Despite the global recession, “the market was ready and very much hoping they would come to market.” Ultimately,

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<sup>337</sup> Organic Law, Article 45: “The authority shall pay annually to the national treasury fees per Panama Canal net ton, or its equivalent, collected from ships transiting the canal, subject to the payment of tolls. These fees, as well as others it must pay, shall be set by the authority and *may not be less than those the Republic of Panama must receive for the same items as of December 31, 1999*” (emphasis added).

<sup>338</sup> Interview by author with Franco Uccelli, December 2, 2014.

<sup>339</sup> The meeting in Guatemala City was held from March 16-17, 2007.

however, investors would be disappointed. The authority – possibly for political reasons, but more likely for lower interest rates and a longer repayment schedule – opted to borrow exclusively from multilateral development banks. On October 14, 2008, Torrijos authorized \$2.3 billion in borrowing. On December 9, 2008, at a ceremony attended by Torrijos and Inter-American Development Bank President Luis Alberto Moreno, the authority signed agreements with five multilateral and official bilateral lenders: \$500 million from the European Investment Bank; \$800 million from the Japan Bank for International Cooperation; \$400 million from the Inter-American Development Bank; \$300 million from the International Finance Corporation, at the World Bank; and \$300 million from the Development Bank of Latin America (Figure 9). The multibillion dollar loan, Torrijos said, signaled international confidence in “the strong financial position and management of the Panama Canal.”<sup>340</sup>

Despite the global economic turmoil, “everyone wanted a piece of this deal,” according to Christopher C. McIsaac, who represented the six lenders for the British law firm Clifford Chance. “Wall Street would have loved to do the deal.”<sup>341</sup> The Inter-American Development Bank highlighted the importance of the expansion for regional commerce. “Our loans to support the expansion of the canal are in line with our collective objectives of supporting economic growth, facilitate world trade, build infrastructure with a solid environmental focus and create employment opportunities,” Moreno said. “It’s an uncommon opportunity to participate in a transaction that involves all these elements at

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<sup>340</sup> “Panama Completes \$2.3 Billion Loan for Canal Expansion Project,” *Latin America Advisor*, October 16, 2008.

<sup>341</sup> Interview by author with Christopher C. McIsaac, September 16, 2014, Washington, D.C.

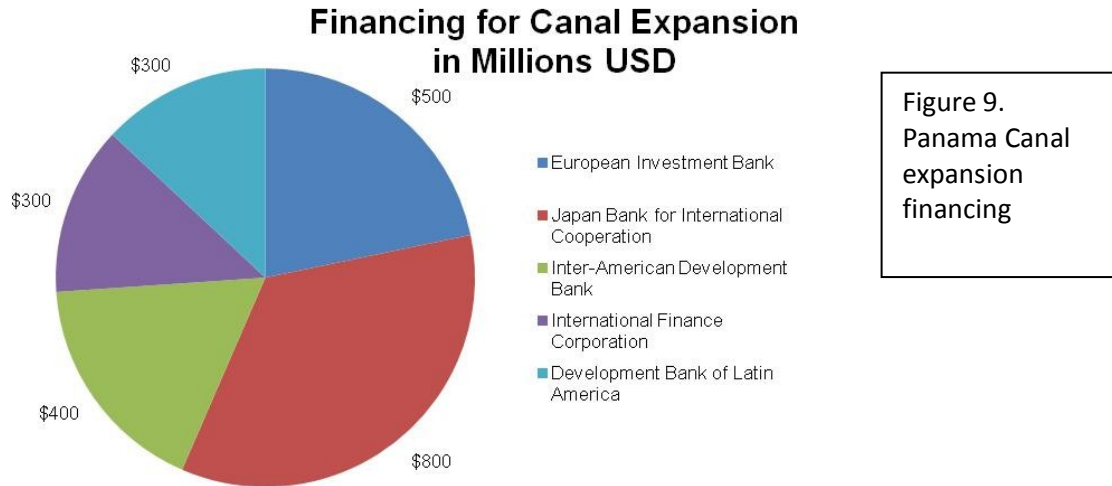
the same time.”<sup>342</sup> For its part, the Japan Bank for International Cooperation emphasized the canal’s importance to Japanese shippers exporting to the U.S. East Coast, noting that ships originating from and destined for Japanese ports made up 14 percent of all canal traffic in 2007, making Japan the canal’s third-biggest user.<sup>343</sup> McIsaac, however, said the strength of the canal business and its clear ability to repay the loans was the driving factor. “It’s a cash cow, it’s incredibly valuable,” he said. “When you look at the business of the Panama Canal, it doesn’t get any better than that. It’s vital and irreplaceable.” Moss, the former U.S. ambassador to Panama, was also not surprised the authority did not have to beg for its loans. “The Panama Canal, entirely in Panamanian hands since 2000, has been hugely successful,” he observed.<sup>344</sup> “Since the turnover, it has experienced increased revenues, added to daily ship transits and maintained a low accident rate. For that reason, Panama was able to raise \$5.25 billion on the private capital market to expand the canal, while offering no government guarantees.”

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<sup>342</sup> Inter-American Development Bank, “IDB, Panama Sign Loan Agreement for Expansion of the Panama Canal, Biggest Infrastructure Project in Latin America,” December 10, 2008, <http://www.iadb.org/en/news/news-releases/2008-12-10/panama-canal,4934.html>.

<sup>343</sup> Japan Bank for International Corporation, “Loan for Panama Canal Expansion Project, Contributing to Japanese International Competitiveness and Stable Resource Supply,” December 10, 2008, <https://www.jbic.go.jp/en/information/press/press-2008/1210-7132>.

<sup>344</sup> Ambler H. Moss Jr., “What Would an Investment Grade Rating Mean for Panama?,” *Latin America Advisor*, February 19, 2010.



## Digging Deep

On September 3, 2007, Panama inaugurated the canal expansion by detonating a hillside beside the waterway.<sup>345</sup> The explosion at Paraíso Hill, a blast “felt around the world,” drew 30,000 spectators.<sup>346</sup> Torrijos stood beside Jimmy Carter and Presidents Álvaro Uribe of Colombia; Antonio Saca of El Salvador; Daniel Ortega of Nicaragua; and Manuel Zelaya of Honduras. From there, the expansion project would involve:

1. Construction of two sets of enormous locks – long enough to accommodate the Empire State Building laid on its side<sup>347</sup> – to be accessed through 10-stories high, Dutch-designed, Italian-built gates that separate the three steps and use double door, rolling gate technology that makes it easier to maintain the locks (the gates do not need to be removed to be repaired at a shipyard);
2. The inclusion of three water reutilization basins;
3. The widening and deepening of navigational channels in Gatún Lake and the canal entrances at the Pacific and Atlantic; and,
4. The deepening of the Culebra Cut.

<sup>345</sup> “Panama Inaugurates \$5.25 Billion Canal Expansion Project,” *Latin America Advisor*, September 7, 2007.

<sup>346</sup> Panama Canal Authority, Annual Report, 2007.

<sup>347</sup> Whitefield November 17, 2012.

The design also called for a four-mile long, 715-foot wide access channel, parallel to the original canal and 33 feet above Miraflores Lake, connecting the new Pacific locks with the Culebra Cut by bypassing the Miraflores and Pedro Miguel locks. (In the original canal, the two-lane Gatún locks raise ships entering from the Atlantic to the level of Gatún Lake, 85 feet above sea level. Ships from the Pacific must transit both the Miraflores and Pedro Miguel locks, two lanes apiece, before achieving their cruising altitude.) The new locks on both sides of the canal would extend 1,401 feet in length and 180 feet in width, the size of four football fields, to use a popular unit of measurement. To get a sense of the scale of the new canal, consider the size of the original waterway. Its ancient lock chambers – 110 feet by 1,000 feet – are as high as an eight-story building. Its miter gates – seven-feet thick, 62 feet wide and as tall as 72 feet – weigh as much as 300 elephants. By comparison, the new locks dwarf the original version, 40 percent longer and 60 percent wider.

To the Panama Canal Authority, the referendum was “one of the most transcendental steps taken by the Panamanian people in the nation’s history.”<sup>348</sup> Yet the successful vote and effortless financing did not erase all concerns about the project. In the days leading up to the Paraíso Hill groundbreaking, analysts still fretted about potential cost overruns.<sup>349</sup> In the United States, that anxiety deepened in July 2009, when Panama passed over U.S. engineering giant Bechtel for the lucrative contract to build the new locks. Instead, Panama chose a consortium – Grupo Unidos por El Canal – led by the Spanish builder Sacyr, that had underbid Bechtel by \$1 billion. The decision followed a

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<sup>348</sup> Suárez 2010.

<sup>349</sup> David Treiger, “Does the Project Still Face Important Hurdles?” *Latin America Advisor*, October 27, 2006.

review by 15 Panama Canal Authority officials, with input from 40 outside experts.<sup>350</sup>

Still, Panama's vice president privately expressed misgivings about the low bid.<sup>351</sup> Canal engineer Luis Ferreira, hired in 2008, recalled the Pacific side construction site in those days as a mosquito infested jungle, overrun by sloths, reindeer, caimans, agoutis and coatis.<sup>352</sup> The 6,000 canal expansion workers, including hundreds of Chileans, Colombians, Nicaraguans, Peruvians and Caribbeans, faced driving rain and lightning.

The gargantuan undertaking started off smoothly. Living up to its environmental commitments, the authority planted thousands of seedlings throughout Panama to compensate for trees it cut down, and relocated more than 5,800 creatures from the construction zone.<sup>353</sup> Eager to avoid cost overruns, the authority contracted international experts to "develop the most accurate and transparent cost and schedule estimates possible."<sup>354</sup> The construction plan incorporated contingencies of one year and \$1 billion.<sup>355</sup> To cut costs, the authority's crews – and the dredges *Mindi* and *Rialto M. Christensen* and drill boat *Thor* – handled navigational dredging and deepening. Excavated material was repurposed to make concrete for the locks and dikes for the new, raised canal channel. In 2010, the expansion was still ahead of schedule and under budget,<sup>356</sup> timed to finish by the canal's 2014 centennial. Thousands of workers staffed day and night shifts, breaking now and again to let archeologists recover artifacts dating

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<sup>350</sup> Panama Canal Authority, Annual Report, 2009.

<sup>351</sup> Kriel, Lomi and Sonya Dowsett, "Lowball Bid Comes Back to Haunt Panama Canal Expansion," *Reuters*, January 20, 2014.

<sup>352</sup> Interview by author with Luis Ferreira, August 23, 2013, Panama Canal, Panama.

<sup>353</sup> Whitefield, Mimi, "Programs Protect Plants and Animals Along Path of the Panama Canal Expansion," *The Miami Herald*, August 26, 2014.

<sup>354</sup> Luis F. Alarcón, David B. Ashley, Angelique Sucre de Hanily, Keith R. Molenaar and Ricardo Ungo, "Risk Planning and Management for the Panama Canal Expansion Program," *Journal of Construction Engineering and Management* 137, 10 (2011): 764.

<sup>355</sup> *Ibid.*, p. 770.

<sup>356</sup> "How Important Is the Canal's Expansion for Panama?" *Latin America Advisor*, April 12, 2010.

back to the French canal diggers. To promote transparency, a Webcam filmed construction and a telephone hotline and e-mail inbox (ampliacion@pancanal.com) collected questions. The expansion, one study concluded in 2011, offered “an outstanding case study and best practices example of project risk management.”<sup>357</sup>

Sensing it was on a roll, the canal authority chronicled every moment of its “magnum opus.”<sup>358</sup> To do so, it established a new multimedia office – the Communication and Historic Documentation Section – with a \$2.5 million budget.<sup>359</sup> Its 20 employees included four photographers and videographers to document the expansion; three archivists to collect artifacts for safekeeping in a warehouse at Corozal Oeste; and writers to compile an oral history of the expansion. The photographers shot 225,000 images, and the videographers captured 230,000 hours of video. So far, the authority has published two volumes of photographs titled, “The Panama Canal Expansion: Portraits of an Historic Undertaking.” It interviewed 250 workers for the oral history. It archived 2 million documents and 900 symbolic objects, ranging from construction uniforms to the detonator that ignited atop Paraíso Hill to inaugurate construction.<sup>360</sup> It commissioned five Panamanian painters – Amalia Tapia, José Inocencio Duarte, Carlos González Palomino, Roberto Vergara del Cid and George Scribner – to capture the construction courtroom sketch-artist style, in watercolor, oil and acrylic. Finally, it invited spectators to watch the project live, inaugurating an observation center to watch the new Atlantic locks come together.

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<sup>357</sup> Alarcón 2011, p. 770.

<sup>358</sup> Panama Canal Authority, Annual Report, 2009.

<sup>359</sup> Interview by author with Ernesto A. Holder, August 5, 2013, Panama City, Panama.

<sup>360</sup> Panama Canal Authority, “Documentación Histórica, Programa de Ampliación del Canal de Panamá,” July 2013.



Outside the construction site, the maritime shipping industry evolved just as Panama predicted. In the intervening years, the West Coast shipping business in the United States had expanded by luring zaftig vessels sized out of the Panama Canal.<sup>361</sup> To fill the shelves at Target, Home Depot, Lowe's and Wal-Mart, ships had continued to increase in girth. Even the cruise ship industry planned ships too large for the canal.<sup>362</sup> Competitors saw opportunities. Neighboring Nicaragua threatened to build a larger, competing canal. (See Chapter 6 for details on the Grand Nicaraguan Canal.) Mexico flirted with a competing, intermodal option, floating a plan to connect its coasts through new highways and railways – a plan also considered by Guatemala, El Salvador and Honduras.<sup>363</sup> (The so-called “canal seco,” or dry canal, in Central America would involve construction of a modern Pacific Ocean container terminal in El Salvador and major upgrades to two Caribbean ports, Puerto Cortés in Honduras and Puerto Barrios in Guatemala.) Others, meanwhile, prepared for the new era following the Panama Canal expansion. The project sparked an “arms race” among East Coast ports, including in Norfolk, Baltimore, Miami, New York and New Jersey.<sup>364</sup> Shippers readied plans to shift away from West Coast ports.<sup>365</sup> Thanks to the Panama Canal Authority's early decision to expand, The Financial Times daydreamed about a “post-Panamax renaissance” for Panama. Panama's economy surged. In 2010, Standard and Poor's upgraded Panama's rating to investment grade.<sup>366</sup> Vice President Joseph Biden, a longtime booster of the

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<sup>361</sup> Kayyem, Juliette, “Panama's Magic Number,” *The Boston Globe*, September 24, 2012.

<sup>362</sup> Whitefield November 17, 2012.

<sup>363</sup> Luxner, Larry, “Canal Alternatives,” *LatinFinance*, March 2007.

<sup>364</sup> Northam, Jackie, “Port of Baltimore Seeks Boost From Panama Canal Expansion,” *NPR*, May 6, 2013.

<sup>365</sup> Wright, Robert, “Panama Canal Expects Boost from U.S. Ports Dispute,” *The Financial Times*, March 3, 2015.

<sup>366</sup> “S&P Upgrades Panama's Debt Rating to Investment Grade” *Latin America Advisor*, May 26, 2010.

canal expansion project,<sup>367</sup> visited the construction site in 2013<sup>368</sup> and thanked Panamanians for their “courage to embark on this significant adventure.”<sup>369</sup> The expansion, he said, “protects Panama’s unique place in the world economy as a new generation of massive container ships and tankers hits the high seas.”<sup>370</sup>

As it turned out, the canal expansion timeline and budget were unrealistic after all. The authority had promised to finish the project by 2014, the canal’s centennial. Instead, the estimated completion date slipped two years, to 2016. In January 2014, Grupo Unidos por el Canal, led by the Spanish construction giant Sacyr,<sup>371</sup> threatened to suspend construction over a bitter and costly payment dispute. In a communiqué, the consortium cited “big financial problems” and demanded \$1.6 billion in additional payments from Panama.<sup>372</sup> The canal authority, Sacyr said, had provided inaccurate information to bidders,<sup>373</sup> including faulty geologic data that resulted in a \$120 million cost overrun for construction of a temporary dam and additional cost overruns for cement production. Martinelli backed the canal authority, but he also blamed authority officials for choosing the consortium, calling its selection “the chronicle of a death foretold.”<sup>374</sup>

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<sup>367</sup> In a speech at the U.S. Department of State on May 9, 2013, Biden called the canal expansion a “game changer.”

<sup>368</sup> On the day of Biden’s visit, Secretary of State John Kerry, in a speech at the Organization of American States, broadly praised progress in Latin America and declared, “The era of the Monroe Doctrine is over.”

<sup>369</sup> Joseph Biden (speech, Panama City, Panama, November 19, 2013). Underscoring the significance of the canal expansion, Biden brought along Transportation Secretary Anthony Foxx; U.S. Sen. Johnny Isakson (R-Ga.); U.S. Rep. Debbie Wasserman Schultz (D-Fla.); as well as the mayors of port cities Baltimore, Atlanta and Philadelphia.

<sup>370</sup> Joseph Biden (press conference with Panamanian President Ricardo Martinelli, Panama City, Panama, November 19, 2013).

<sup>371</sup> The other companies in the consortium include Italy’s Impreglio, Belgium’s Jan de Nul and a local Panamanian firm, Constructora Urbana.

<sup>372</sup> Fernandez, Marco A. “Panama, Happy New Year?,” *INDESA*, January 4, 2014.

<sup>373</sup> Toyer, Julien, “Sacyr Says Has \$574 Million at Stake in Panama Contract,” *Reuters*, January 11, 2014.

<sup>374</sup> “Panama President Blames Former Canal Chief for Crisis,” *Agence France-Presse*, February 11, 2014.

Critics of the original contract reemerged in an I-told-you-so chorus.<sup>375</sup> It was an easy target. The major consultant on the project, Parsons Brinckerhoff, previously led construction of the Big Dig, the Boston tunnel project that saw its original \$2.6 billion price tag balloon to \$14.6 billion. Critics recalled Bechtel's earlier complaints that the winning bidder had offered a price barely sufficient to cover the cost of the concrete.<sup>376</sup> "This is what happens often when you go with the lowest bidder," Adie Tomer, a senior research associate at the Brookings Institution and a member of its Metropolitan Infrastructure Initiative, said.<sup>377</sup> Canal officials, generally prone to braggadocio, called the expansion a "humbling project."<sup>378</sup>

The Panama Canal Authority vigorously defended its project management, and threatened to take over construction from Sacyr.<sup>379</sup> "Contractors are experts in selling you mirror tricks," the authority's program manager grumbled to participants at the Panama Canal Symposium in 2012.<sup>380</sup> The authority's allies pointed out Sacyr's history of underbidding jobs and demanding higher payments.<sup>381</sup> (Together, Sacyr and Italy's Salini Impregilo control 96 percent of the consortium.<sup>382</sup>) Throughout the imbroglio, analysts expressed confidence in the authority. "Completion of the canal expansion is a foregone

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<sup>375</sup> Webber, Jude, "Panama Canal Dispute Throws \$5.2 billion Expansion Project Into Disarray," *The Financial Times*, February 5, 2014.

<sup>376</sup> Sparrow, Thomas, "Panama Canal Expansion Project: Have American Fears Come True?" *BBC*, January 13, 2014.

<sup>377</sup> Interview by author with Adie Tomer, November 5, 2014.

<sup>378</sup> Jorge Quijano quoted in "Panama Canal, Post Panamax," a documentary by the Community Television Foundation of South Florida, 2015.

<sup>379</sup> Kriel, Lomi, "Panama Canal Threatens to Take Over Key Expansion Project," *Reuters*, January 14, 2014.

<sup>380</sup> Aileen Cho and C.J. Schexnayder, "Global Talent Converges on Panama Canal," *ENR: Engineering News-Record*, Vol. 268, No. 13 (2012).

<sup>381</sup> Jaime Figueroa Navarro, "Has the Dispute Affected the International Community's Perception of Doing Business in the Central American nation?" *Latin America Advisor*, March 6, 2014.

<sup>382</sup> Molinski, Dan, "Panama Canal Expansion Slows Sharply as Deal Remains Elusive, European Construction Companies Want Panama to Pay for Extra Costs," *The Wall Street Journal*, January 20, 2014.

conclusion,” a J.P. Morgan report informed investors in January 2014.<sup>383</sup> “The recent noise related to the canal expansion appears unlikely to have long-lasting negative consequences.” Even a kitchen remodeling often suffers cost overruns, Uccelli, the J.P. Morgan analyst, said. “It is par for the course.” (The cost of the original canal, \$326 million not adjusted for inflation, was twice the initial estimate,<sup>384</sup> and that excludes \$53 million in repairs following devastating landslides in 1916 and 1917, shortly after the canal opening.<sup>385</sup>) Indeed, construction on the canal expansion ultimately continued despite the dispute over the cost overruns. The cost overruns, moreover, were caused at least in part by the unanticipated construction boom in Panama City that inflated the costs of labor and materials.<sup>386</sup> In 2007, for example, the construction sector expanded by 25 percent. That created fierce competition for concrete and steel, which the expansion required in mind-blowing quantities. “It’s unusual for a project of that magnitude to ever be concluded on the first announced schedule,” Koch, president of the World Shipping Council, said.<sup>387</sup> Nevertheless, the troubles dinged the Panama Canal Authority’s otherwise sterling reputation.

### **The King is Dead, Long Live the King**

In 2012, the canal authority faced yet another defining test: the selection of the canal’s chief executive officer, known as its administrator. Legendary canal administrator Alberto Alemán had been selected for the first of his two seven-year terms under U.S. management in 1996. So choosing his replacement gave Panama its first opportunity to

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<sup>383</sup> Uccelli, Franco A. “Panama Trip Notes, Current Dispute Unlikely to Derail Canal Expansion,” *J.P. Morgan Latin America Emerging Market Research*, January 28, 2014.

<sup>384</sup> Maurer 2010, p. 98.

<sup>385</sup> Ibid., p. 103.

<sup>386</sup> Interview by author with Luis Ferreira, Panama City, Panama, August 23, 2013.

<sup>387</sup> Koch 2014.

prove it could repress its notorious and destructive patronage instincts. The timing was not ideal. Martinelli, the president since 2009, was dogged by allegations of corruption and authoritarian tendencies. (He is now a fugitive, avoiding corruption charges.) As his power increased, the attorney general and comptroller lost their independence.<sup>388</sup> The founder of the Super 99 supermarket chain, he had continued to use his corporate e-mail address while in office and was expected to value loyalty over qualifications in filling the canal authority's top job. He had "sold Panamanians a Bloomberg-type of leadership, instead, he became a Berlusconi."<sup>389</sup> The maritime industry held its breath.<sup>390</sup> "Many people doubted they would chose someone who was not a friend of the president," Quirós, who served on the authority's board during the search for Alemán's successor, said. Now the president of the newspapers *El Siglo* and *La Estrella*, where the lobby wallpaper features historic front pages dominated by canal-related headlines such as "Un Solo Territorio" ("A United Land"), "Nuevo Tratado Firman Carter-Torrijos" ("Carter and Torrijos Sign New Treaty") and "Panama Perfecciona Independencia" ("Panama Completes its Independence"). Quirós remembers the tense months preceding the board's 2012 vote on a new administrator. Canal pilots, engineers and executives regularly approached him to express fears of political intervention. Twitter and Facebook lit up with protests against the rumored appointment of a politically connected candidate. "We were scared to death about what would happen," the head of the operations division,

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<sup>388</sup> O'Grady, Mary Anastasia, "Panama's King Moves the Queen," *The Wall Street Journal*, April 14, 2014.

<sup>389</sup> Fernando Berguido, "The Isthmus and its Challenges," *ReVista Harvard Review of Latin America*, Spring 2013.

<sup>390</sup> Economist Intelligence Unit, "New Administrator Takes Over at Panama Canal," October 15, 2012.

Miguel F. Rodríguez, said. “We don’t want any politics in the canal. That would be the end. It’s like a cancer.”<sup>391</sup>

Technically, the decision rested entirely with the canal authority’s Board of Directors.<sup>392</sup> But the board was considered malleable, in part because it had no strict guidelines to follow in evaluating applicants. Article 23 of the canal’s organic law required only that the administrator be a Panamanian citizen; hold a university degree (or have sufficient practical experience); boast a clean criminal record; and have no relation to board members or the deputy administrator. “Although choosing the new Panama Canal Authority administrator is the sole responsibility of the [authority’s] board, political and civil society sectors do not rule out the influence that President Ricardo Martinelli may have in that election,” Panama’s *La Prensa* newspaper reported in January 2012. General concerns about Martinelli persisted throughout his presidency and beyond. In 2014, the opposition candidate, Juan Carlos Varela, campaigned successfully against Martinelli’s chosen successor (the Panamanian constitution prohibits consecutive presidential terms) by railing against public corruption and Martinelli’s “iron fist-style of leadership.”<sup>393</sup> Several of Martinelli’s canal board nominees had questionable credentials. Practically the moment Martinelli left office, Panama’s Supreme Court appointed a special prosecutor to investigate allegations that he inflated multimillion dollar contracts.<sup>394</sup>

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<sup>391</sup> Interview by author with Miguel F. Rodríguez, August 15, 2014.

<sup>392</sup> Article 319 of Panama’s constitution gives the canal authority board the power to “appoint and remove the administrator and deputy administrator of the canal.”

<sup>393</sup> Archibold, Randal C., “Incumbent’s Party Loses Presidency in Panama,” *The New York Times*, May 4, 2014.

<sup>394</sup> “Panama Ex-Leader Ricardo Martinelli Faces Corruption Probe,” *BBC*, January 29, 2015.

On Martinelli's watch, however, an undisputed expert, longtime canal executive Jorge L. Quijano, landed the Panama Canal Authority's top job. Quirós insisted there was "zero political influence" in the process. "There is an invisible wall you cannot cross," he said. The chairman of the canal authority board, Georgia Tech graduate Roberto Roy, agreed. Roy, who also holds the title of canal minister, is the only board member appointed unilaterally by the president. Still, he said, he rarely hears from the president, except during his monthly presidential briefings on the canal expansion. "The president has a miniscule role in the canal. A lot of people don't believe that," he said.<sup>395</sup> "My conversations with the president on the canal are very few." That separation, Roy said, includes issues related to canal personnel and even the canal budget, which the board shares with the president on the same day the president's cabinet members receive their official copies.

On March 9, 2012, a Friday, the Panama Canal Authority board informed reporters gathered in Building 710 that it had elected Jorge L. Quijano to succeed Alemán. Rómulo de Roux, the canal minister at the time, said the search lasted six months.<sup>396</sup> "Quijano has the canal in his veins," Roux said. Indeed, Quijano was the farthest thing from a Martinelli crony. An industrial engineer, Quijano had 36 years of experience at the canal at the time of his appointment, beginning in 1975.<sup>397</sup> Since September 2006, he had supervised the canal expansion. On September 3, 2012, his first day as administrator, Quijano simply swapped canal authority offices, carting his belongings to the historic canal headquarters building. (The imposing, hilltop structure,

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<sup>395</sup> Interview by author with Roberto Roy, August 26, 2013, Panama City, Panama.

<sup>396</sup> Garrido A., Elizabeth, "Jorge Quijano, Nuevo Administrador del Canal," *La Prensa*, March 9, 2012.

<sup>397</sup> "Jorge L. Quijano, Chief Executive Officer, Panama Canal Authority," Panama Canal Authority, <http://www.pancanal.com/eng/general/junta-directiva/jlquijano.html>.

commissioned in 1912 by Goethals, the chief engineer of the original canal construction project, opened on July 15, 1914, a month before the canal itself began operating. Its architect, the New Yorker Austin W. Lord, also designed the three locks control houses, the Balboa and Cristóbal train stations, the Gatún hydroelectric plant and several houses.<sup>398</sup>) Independent observers applauded Quijano's selection. "He's an individual that's hard to find in any country, but particularly in a smaller country like Panama where everybody is tied into family and politics," said Richard Wainio, director and CEO of the Tampa Port Authority, who started a long career at the U.S.-run Panama Canal Commission in 1975. "Jorge clearly has been a professional and not a politician for his entire career."<sup>399</sup> Shippers, who had "expressed concerns over political meddling in the new administrator's designation,"<sup>400</sup> considered Quijano an internationally recognized professional. In remarks at his swearing-in ceremony, Quijano seemed to recognize that the search for a new administrator had awoken concerns over the canal authority's independence. "We will continue to be strict custodians of this management model," he reassured his staff and the international community, "devised by Panamanians for the benefit of world maritime commerce and of Panama."<sup>401</sup> The board itself highlighted the importance "institutional continuity."<sup>402</sup>

## **Industry views**

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<sup>398</sup> A second New Yorker, William B. Van Ingen, who painted the murals in the Administration Building rotunda depicting canal construction, is better known for painting murals in the U.S. Library of Congress.

<sup>399</sup> Leach, Peter T., "Quijano Prepares For New Job as Panama Canal Authority Administrator," *Journal of Commerce*, May 28, 2012.

<sup>400</sup> "New Administrator Takes Over at Panama Canal," *Economist Intelligence Unit*, October 15, 2012.

<sup>401</sup> Leach, Peter T., "Quijano Takes Over As Canal Administrator," *Journal of Commerce*, September 4, 2012.

<sup>402</sup> Panama Canal Authority, *Annual Report*, 2012.



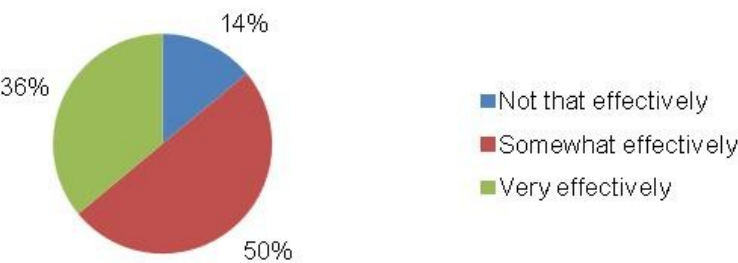
Shipping companies are impressed. Questionnaires administered by the canal authority show high levels of customer satisfaction. The author's independent survey of senior executives at the world's largest shipping companies supported that conclusion. Asked about their previous expectations for a Panama-run canal, 64 percent of respondents from the World Shipping Council and the American Maritime Congress said they expected Panama to run the canal either "not that effectively" or "somewhat effectively" (Figure 10).<sup>403</sup> Describing the actual performance of the canal authority, all respondents classified it as satisfactory, reporting that Panama runs the canal "somewhat effectively" or "very effectively" (Figure 11). "Not much has changed on the base model which existed under the U.S., and improvements on that base model have been made, though at a higher expense to the user," one respondent observed. The responses were not overly enthusiastic; only a small minority of respondents, for example, consider Panama an improvement on the United States when it comes to canal maintenance, safety, speed, customer service or over all value. Seventy-two percent consider toll increases as "somewhat unreasonable" or "very unreasonable." Over all, however, the industry's terror at the prospect of Panamanian canal supervision has been replaced by admiration. "All the doomsayers," Lewis said, "have been proven wrong."<sup>404</sup>

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<sup>403</sup> The author surveyed members of two industry associations, relying upon an e-mail invitation for recruitment and a Web-based questionnaire. The invitation went out to senior executives at every member company of the World Shipping Council, and to senior executives at several member companies of the American Maritime Congress, selected by the American Maritime Congress's president based on the likelihood of a response. In all, 14 individuals completed the survey. The 28 member companies of the World Shipping Council account for 90 percent of the global liner vessel capacity, according to the council. The council's geographically diverse roster of member companies includes Maersk, of Denmark; the Hanjin Shipping Company, of Korea; and the Mitsui O.S.K. Lines and NYK Line, both of Japan. The American Maritime Congress advocates for the U.S.-flag merchant marine and maritime industry. Its 19 member companies include the Alaskan Tanker Company, of Beaverton, Ore., and Horizon Lines, of Charlotte, N.C.

<sup>404</sup> Lewis 2013.

**How effectively did you expect the Panama Canal Authority to operate the canal once in control?**



**How effectively does the Panama Canal operate the canal today?**

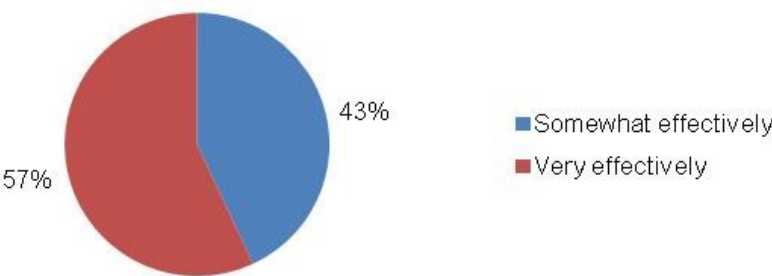


Figure 11. Industry assessment of Panama's Panama Canal management

## **Chapter 4: How did Panama pull it off? Identifying the roots of the Panama Canal Authority's success, historical, institutional and sociological**

### **Introduction**

Panama did not dig the Panama Canal. It did not even try. In 1830, it was the Dutch who first attempted to construct a canal in Panama, before a revolution in Holland interrupted the project.<sup>405</sup> Next came a Frenchman, Ferdinand de Lesseps (1805 to 1894). Beginning in 1879 in what was then Colombia's northernmost province, de Lesseps, the engineer behind the Suez Canal, sought to recreate a sea-level canal in Central America. The French had been enticed by the increased transisthmian traffic generated by the California gold rush. By 1884, de Lesseps's 19,243 workers, mainly Jamaicans, had removed 59,747,620 cubic meters of rock and soil, scooped up and transported by dump carts, cranes, dredges and steam shovels. But the French efforts foundered, lacking adequate machinery and funds and ravaged by tropical disease and landslides. In all, 20,189 died in de Lesseps's failed project, felled by malaria, yellow fever, typhoid, dysentery, snakebites and accidents. The disaster was so notorious that in modern France, the phrase "Quel Panama!" has come to mean, "What a mess!"<sup>406</sup>

The Panamanian jungle gradually enveloped the rusting, abandoned French machinery after de Lesseps decamped in 1889.<sup>407</sup> But the disappointed Panamanians de Lesseps left behind were not entirely passive. Local elites blamed their rulers in Bogotá, the faraway Colombian capital, for the French project's failure, adding to their long list of

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<sup>405</sup> Thomas M. Leonard, *Panama, the Canal and the United States: A Guide to Issues and References* (Claremont, Calif.: Regina Books, 1993), p. 54.

<sup>406</sup> Noel Maurer and Carlos Yu, *The Big Ditch: How America Took, Built, Ran and Ultimately Gave Away the Panama Canal* (Princeton, N.J.: Princeton University Press, 2010), p. 62.

<sup>407</sup> The French left behind heaps of rusted machinery, discarded trains with trees growing out of the fireboxes, and 2,000 houses infested with termites.

historical grievances. Panamanian frustration boiled over in August 1903, when the Colombian legislature rejected an agreement negotiated by U.S. Secretary of State John Hay and signed on January 22, 1903, that would have granted the United States the right to build a canal through Panama.<sup>408</sup> Panamanians feared that the rebuffed United States would opt for a Nicaraguan canal instead. It was a reasonable concern. U.S. East Coast exporters looking to expand trade with East Asia and South America's west coast had been lobbying hard for a canal, but the location was up for grabs. In fact, in 1876, President Ulysses S. Grant's Interoceanic Canal Commission had endorsed Nicaragua's San Juan River as the ideal canal site.<sup>409</sup> Starting in 1887, the privately owned Maritime Canal Company spent three years and \$4 million on an unsuccessful attempt to dig a waterway through Nicaragua.<sup>410</sup> In 1900, Hay signed an agreement to negotiate a U.S. government-built canal in Nicaragua.

Panama had advantages over Nicaragua, including a shorter distance across the isthmus, completed French excavations and leftover French equipment, priced to sell. Recognizing those conditions, the U.S. Congress, on June 28, 1902, passed the Spooner Act, authorizing President Theodore Roosevelt (1901 to 1909) to pay \$40 million for the French rights and property in Panama. Still, the thwarted U.S. agreement with Colombia put the Panama project in doubt, and that animated Panamanian separatists. In 1903, after Colombian lawmakers had turned down the United States, the Panamanian Manuel Amador Guerrero sailed to New York City to secure support from Roosevelt for

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<sup>408</sup> The United States offered Colombia \$10 million and a \$250,000 annual payment, the precise terms the newly independent Panama accepted on December 2, 1903.

<sup>409</sup> Grant had a personal understanding of the challenges of crossing the pre-canal isthmus; in 1852, he led members of his U.S. Army regiment and their families across Panama, and saw more than 100 die, mainly from cholera.

<sup>410</sup> Leonard 1993, p. 60.

Panamanian independence. Roosevelt, infuriated by the Colombian “blackmailers,”<sup>411</sup> was receptive. On November 2, 1903, the USS Nashville docked at Colón, on Panama’s Atlantic coast, to discourage Colombian troops from quashing the expected Panamanian rebellion. At the same time, the U.S. administrator of the Panama railroad, James S. Shaler, denied Colombian soldiers access to the transisthmian railway. The following day – November 3, 1903 – the Panamanians revolted. On November 6, 1903, with U.S. warships patrolling Panama’s coasts, Roosevelt recognized the new Panamanian republic.

At last, Panama controlled its destiny. But yet again, it was foreigners who carried shovels into the Panamanian jungle. On November 18, 1903, Hay signed the Hay-Bunau-Varilla Treaty, granting Panama a \$10 million lump sum payment and \$250,000 in annual rent for perpetual U.S. control over a central expanse of Panamanian territory. This time, the project’s chief engineer would be a U.S. Army coronel, George W. Goethals. Goethals had a better plan than the French – a locks canal, requiring far less excavation – and better timing, too. Taking advantage of technological advances, Goethals deployed steam shovels, dynamite and locomotives to dig and cart off 232 million cubic yards of rock and soil. At its peak, the U.S. Isthmian Canal Company numbered 44,000 employees, including nearly 20,000 Barbadians who had sailed 12 days for the job. Goethals had another asset de Lesseps lacked: Col. William Gorgas, the Isthmian Canal Company’s chief sanitary officer. Deploying newly developed disease management techniques, Gorgas contained yellow fever and malaria by controlling Panama’s mosquito population, covering, screening and oiling sitting water and draining swamps where mosquitoes bred. Despite a technological and medical edge, U.S. construction still lasted a decade – from 1904 to 1914 – and cost \$380 million. But this

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<sup>411</sup> Maurer 2010, p. 82.

time, the project ended in success. On August 15, 1914, the SS Ancon cargo ship crossed the canal. Panama had outsourced the job, but it got its canal.

### **U.S. Transition: Path Dependency**

By the end of the Twentieth Century, the United States would hand over that canal. Along with it, the United States would transfer the 364,201-acre Panama Canal Zone; 728 buildings; two dredges, Mini and Rialto M. Christensen; floating cranes, such as Titan and Goliath; and an armada of tugboats and patrol craft. Importantly, just as Panama would inherit the ditch, locks and tugboats, houses and workshops, on December 31, 1999 Panama also would get its hands on a functioning canal administration. That would include a cadre of U.S. workers and thousands of Panamanians trained by the United States. Panama would also receive corporate attitudes, practices and regulations established over eight decades of U.S. canal management. Yet again, as with its reliance upon U.S. canal builders, it could be said that Panama's biggest achievement would simply involve preserving its bequest.

In Panama, the historiography of the transition of the canal to Panamanian control emphasizes Panamanian gumption in the face of a U.S. government disinterested in a waterway it built, but would soon abandon. The notion that Panama has sailed on the fair winds of path dependency is given little consideration. That narrative is partially accurate, as will be discussed in detail below. But it understandably riles former U.S. canal officials who spent two decades preparing Panama for its canal responsibilities. The 1977 Panama Canal treaties replaced the Panama Canal Company with the U.S.-led, binational Panama Canal Commission, and that commission invested mightily in training

Panamanians to take U.S. canal jobs. The treaty mandated the “growing participation of Panamanian nationals” in canal administration, “with the objective of preparing, in an orderly and efficient fashion, for the assumption by the Republic of Panama of full responsibility for the management, operation and maintenance of the canal.” It discouraged recruiting non-Panamanians for jobs, prohibited discrimination based on nationality and required ramped-up training. By most accounts, the United States complied enthusiastically. Panama Canal Commission annual reports, tracking the progress of a preferential hiring program, reveal slow but steady progress expanding the Panamanian presence in the Panama Canal. In 1986, Panamanians comprised 81 percent of the canal workforce.<sup>412</sup> That crept up to 83 percent in 1987<sup>413</sup> and to 84 percent in 1988.<sup>414</sup> By 1995, Panamanians held 90 percent of canal jobs<sup>415</sup> and in 1999, the final year of U.S. ownership, the 7,073 Panamanian canal workers made up 96 percent of the canal workforce.<sup>416</sup> The same trend was evident in the canal administration’s upper ranks. In 1978, at the start of the transition to Panamanian management, Panamanians occupied just 7 percent of canal management positions and 2 percent of canal pilot slots. By 1999, 78 percent of canal managers were Panamanian, as were 81 percent of pilots.<sup>417</sup> In other words, the U.S.-led transition of ownership of the U.S.-built canal was a carefully thought-out and executed process. Sure, it had its faults. But contrary to many Panamanian accounts, it did not resemble Belgium’s infamous departure from the Congo, where colonial authorities deposited a flimsy government known as “le parti congolais”

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<sup>412</sup> Panama Canal Commission, “Annual Report,” 1986.

<sup>413</sup> Panama Canal Commission, “Annual Report,” 1987.

<sup>414</sup> Panama Canal Commission, “Annual Report,” 1988.

<sup>415</sup> Panama Canal Commission, “Annual Report,” 1995.

<sup>416</sup> Panama Canal Commission, “Annual Report,” 1999.

<sup>417</sup> Omar Jaén Suárez, *Diez Años de Administración Panameña del Canal* (Panama City, Panama: Panama Canal Authority, 2010), p. 37.

in a messy affair that continues to plague the wartorn country. In sharp contrast to U.S. training and recruitment efforts in Panama, Belgium left the Congolese with an army officer corps that was entirely European at independence – on June 30, 1960 – prompting a mutiny followed by the abrupt, total “Africanisation” of the Congolese officer corps. Similarly, the senior level of the Congolese bureaucracy was wholly European at independence, with zero access for Zaireans until 1959; in 1960, only three Zaireans were among the 4,645 holders of senior executive posts. In the chaos and violence of independence, most European civil servants fled, resulting in the sudden, mass promotions of lower-level officials.<sup>418</sup> In that context, the Panama Canal transition was a “textbook case,” as Ricardo Alberto Arias, Panama’s former foreign minister,<sup>419</sup> has described it.

As discussed, the Panama Canal’s remarkable personnel transformation did not occur by chance. Undoubtedly, abnormally high turnover – 7.2 percent in 1980, for example – helped open positions for Panamanians. In the years after the ratification of the treaties, droves of U.S. canal workers packed their bags, lured by generous pension offers; repulsed by the prospect of life under the jurisdiction of Panama’s repressive National Guard; and later intimidated by Panamanian dictator Manuel Noriega’s henchmen. But the biggest factors in strengthening the Panamanian canal workforce were the U.S.-administered Panamanian Preference Program and related efforts to recruit and mentor Panamanians. “To ensure that the necessary strengths are available in the critical years ahead, training programs continue to receive high priority, with a major emphasis on increasing the participation of qualified Panamanians,” Gen. Dennis P. McAuliffe, the

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<sup>418</sup> The description of Congo’s independence is based upon Volume 8 of *The Cambridge History of Africa*.

<sup>419</sup> Interview by author with Ricardo Alberto Arias, Panama City, Panama, August 27, 2013.



canal administrator (1979 to 1989), reported in 1985.<sup>420</sup> To bring Panamanian pilots aboard, for example, the United States jettisoned a requirement that pilot candidates be blue water sailors with a master's license. Instead, the Panama Canal Commission enrolled Panamanians in maritime schools, set up apprenticeship programs and provided scholarships for Panamanians to study in the United States. Manuel E. Benítez, now the deputy canal administrator, studied management at Cornell. So did Enrique E. Sánchez, now the head of the canal's purchasing division. To speed the advancement of Panamanian canal officials, the United States established a three-member promotion panel and mandated that at least one member be Panamanian.<sup>421</sup> In all, these training efforts cost millions of dollars.<sup>422</sup> For Panamanians, the pace of hiring and promotions was always too slow, a chronic source of tension on the commission's nine-member, binational Board of Directors. But those disagreements were unavoidable, given the canal commission's dual roles: advance the transition while safely operating the critical waterway. "We were going to do it right. That means you did not go out willy-nilly hiring Panamanians," recalled Richard Wainio, who served as the commission's director of executive planning and is now CEO of the Tampa Port Authority.<sup>423</sup> "You had to continue to operate the canal successfully and that by itself was a big job. Then you had the job of implementing the treaty."

Joseph Wood, who directed the commission's Office of Executive Administration from 1980 to 1993, also acknowledged an initial reluctance to flood the canal with Panamanian newcomers. Wood, however, said cultural factors also played a role in hiring

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<sup>420</sup> Panama Canal Commission, "Annual Report," 1985.

<sup>421</sup> Interview by author with Joseph Wood, May 11, 2015.

<sup>422</sup> Richard Wainio quoted in Ana Elena Porras's *Historias Canaleras: Doce Testimonios de la Transición* (Panama City, Panama: Universidad de Panamá, Instituto de Estudios Nacionales, 2007), p. 158.

<sup>423</sup> Interview by author with Richard Wainio, September 2, 2014.

decisions. Like many U.S. canal employees, Wood's family had deep roots in Panama. His great grandfather, James Moore, was a British sailor whose steam ship transported mail and passengers between San Francisco and Panama. Moore settled in Panama in the late 19th century, after meeting his future wife on the Panamanian island of Taboga, a coaling station at the time. The couple settled in Panama, constructing their home on Taboga out of California redwood. Generations later, when U.S. authorities directed U.S. canal employees to begin the handover, these historic ties, such as those in Wood's family, proved hard to break. "It took a while for the attitudes to become positive," Wood recalled of the transition to Panamanian canal administration. "Most of us were second or third generation; this was our home." But as canal administrator, McAuliffe communicated a clear commitment to the transition and "after three or four years, we got over the angst," Wood said. Ultimately, the United States developed a team of Panamanians prepared to run the canal at every level of its administration. Even today, nearly all of the canal's top officials trained as U.S. apprentices.<sup>424</sup>

Beyond U.S.-built infrastructure and U.S.-trained personnel, Panama benefited from institutional designs and norms fashioned by generations of U.S. canal officials. In the final years before the turnover, as Panamanians contemplated the canal's future administrative structures, Panamanian elites recognized the value of the canal's administrative structures. Gilberto Guardia Fabrega, the first permanent Panamanian canal administrator (1990 to 1996), spoke admiringly of the U.S.-led Panama Canal Commission. His successor, Alberto Alemán Zubieta (1996 to 2012), made a similar

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<sup>424</sup> Rogelio Gordon, head of the Panama Canal Authority's dredging division, quoted in "Panama Canal: Prized Possession" (Community Television Foundation of South Florida, 2015).

observation; he promised global shippers that they would notice no changes following the turnover.

The United States did not merely lead by example as Panama debated the future design of its Panama Canal Authority, as Panama called the latest iteration of the canal administration. U.S. officials nudged Panama to establish a strongly independent canal entity. In 1993, the United States commissioned a report from the consultancy Arthur Anderson that scrutinized the U.S.-led transition. Its conclusions, largely accepted by U.S. authorities, included a recommendation that the United States encourage “the Panamanian government to adopt an apolitical strategy for managing the canal.”<sup>425</sup>

Arthur Anderson also urged the United State to:

1. Recognize Panama’s interest in running a “business-oriented canal” and take steps so that “U.S. oversight can be adapted to serve those same objectives”;<sup>426</sup>
2. Participate in Panamanian dialogues regarding “the structure of canal governance under Panama, the legislative framework that will apply to the canal and myriad operating policies and practices”;<sup>427</sup> and,
3. Replace the rigid policies of a U.S. Executive Branch appropriated agency and adopt “commercially accepted practices and procedures regarding budgeting, procurement, personnel and ethics which reflect the needs of the transitional period and which can be adopted by the post-1999 canal organization.”<sup>428</sup>

After Panamanian lawmakers, on December 27, 1994, passed a constitutional reform establishing the Panama Canal Authority, the U.S.-led Panama Canal Commission praised the design and its similarities to U.S. structures. The future canal authority, the commission observed, would “allow the preservation of proven policies, regulations and procedures” and guarantee “the continuity of its labor force by providing employment

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<sup>425</sup> Arthur Anderson, *Panama Canal Commission, Assessment of Proposal for Organizational and Management Change* (Washington, D.C.: U.S. General Accounting Office, 1993), p. 2.

<sup>426</sup> Arthur Anderson 1993, p. 19.

<sup>427</sup> Ibid., p. 22.

<sup>428</sup> Ibid., p. 29.

conditions and rights similar to those existing at the time of the transfer of the canal.”<sup>429</sup>

As Panamanian lawmakers began drafting the future canal authority’s basic law, U.S. canal officials coordinated with the Panamanian government’s canal transition commission, established on January 25, 1995. In the meetings, the United States highlighted “key elements which have contributed to the successful operation of the canal over the years, including organizational and managerial structure, personnel administration programs, labor policies and programs, financial system, tolls policy and procurement policies and programs. The importance of continuing these key functions to ensure the canal’s future effectiveness and dependability under Panama’s stewardship was stressed.”<sup>430</sup> The U.S.-led Panama Canal Commission assigned U.S. lawyers and U.S. planners to help adapt canal regulations – including inventory and supply management systems – to Panama’s legal system.<sup>431</sup> What’s more, 600 U.S. canal officials hung around in 2000 to provide continuity following the canal turnover.<sup>432</sup> Sixteen years later, there are still 15 U.S. nationals in the canal’s locks division,<sup>433</sup> and the top four canal pilots, by seniority, are Americans.<sup>434</sup> Before the turnover, U.S. canal officials had even started planning for the canal’s eventual expansion. An internal memorandum to the canal administrator, sent October 8, 1997, detailed long-term projections of canal traffic and modeled traffic patterns for a hypothetical, widened canal. (Later, the expansion would not only rely upon U.S. studies, but also take advantage of preliminary U.S. excavations on the canal’s Atlantic side.) Over all, the transition to

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<sup>429</sup> Panama Canal Commission, “Annual Report,” 1995.

<sup>430</sup> Ibid.

<sup>431</sup> Wainio September 2, 2014.

<sup>432</sup> Interview by author with Elizardo Morales, Panama City, Panama, January 18, 2013.

<sup>433</sup> Interview by author with Abdiel Pérez, Panama City, Panama, August 23, 2013.

<sup>434</sup> Interview by author with Miguel F. Rodríguez, Panama City, Panama, August 15, 2014.

<sup>435</sup> At the time of the transfer, 39 of the 280 canal pilots were U.S. nationals, as well as four of the 110 canal tug boat pilots (Suárez 2010, p. 89).

Panamanian canal control “was not very traumatic,”<sup>436</sup> Samuel Lewis Navarro, Panama’s former vice president and foreign minister, concluded.

Even the harshest critics of the transition process recognize U.S. fingerprints on the Panama Canal Authority’s notable institutional design, including the labor and procurement policies that serve as the foundation of the Panamanian-run waterway.<sup>437</sup> (There are legitimate criticisms of the U.S. handling of the transition, which will be addressed separately.) The United States had provided office space at the canal’s Administration Building<sup>438</sup> for the executive director of the Panamanian government’s canal transition commission, and it used that proximity to influence the drafting of the Panama Canal Authority’s basic law. In the final annual report of the U.S.-led Panama Canal Commission, Alemán, the Panamanian canal administrator at the time, praised the United States for its handling of the transition: “I am proud to report that the Governments of the United States and the Republic of Panama have labored in true partnership to ensure a smooth and orderly transfer. This noble process has provided a solid foundation upon which we pledge to continue building a safer, more efficient and competitive Panama Canal under Panamanian administration.”<sup>439</sup> Charles Morris, the U.S.-led Panama Canal Commission’s head of security, remembers a flawless transition. “Looking back,” he said, “I wouldn’t have done anything differently.”<sup>440</sup> By the time the Panamanians inherited the canal, he said, its continued operation was child’s play. “The canal is a perpetual motion machine,” he said, “it runs itself.”

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<sup>436</sup> Interview by author with Samuel Lewis Navarro, Panama City, Panama, August 21, 2013.

<sup>437</sup> Ana Elena Porras, *Historias Canaleras: Doce Testimonios de la Transición* (Panama City, Panama: Universidad de Panamá, Instituto de Estudios Nacionales, 2007), p. 217.

<sup>438</sup> Panama Canal Commission, “Annual Report,” 1996.

<sup>439</sup> Panama Canal Commission, “Annual Report,” 1999.

<sup>440</sup> Porras 2007, p. 150.

Prone to self-congratulation, Panama sometimes needs reminding that it was born on third base and dreamed it hit a triple, as former Texas Governor Ann Richards (1991 to 1995) famously said of her successor, George W. Bush. “It was a U.S. effort, and people lose sight of it,” Wainio complained.<sup>441</sup> After all, why would the United States set the stage for failure at a canal so central to the U.S. economy? True, the canal is a global enterprise, with ships from 100 countries among the 14,000 vessels transiting annually. But the United States remains the major user. The United States is the origin or destination of two thirds of the ships transiting the canal. The canal processes 37 percent of the imports at the Savannah port, 28 percent at Miami and 22 percent at New York and New Jersey.<sup>442</sup> Fully one-third of U.S. grain and soybean exports pass through the canal.<sup>443</sup> U.S. companies also use the canal to ship phosphates, petroleum products, chemicals, lumber, iron and steel,<sup>444</sup> routed through Panama to cut distance, time and cost. Cargo crosses Panama headed between Europe and the U.S. West Coast; between Southeast Asia and the U.S. East Coast; and from coast to coast in the United States. The canal was and remains “a lifeline for trade and commerce for the United States,” which “connects directly to questions of economic development and job creation.”<sup>445</sup>

To its credit, most often Panama grudgingly acknowledges its extraordinary inheritance.<sup>446</sup> At the Centro de Capacitación Ascanio Arosemena, a canal training complex at the former Balboa High School, the plaza is dominated by a monument to the

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<sup>441</sup> Wainio September 2, 2014.

<sup>442</sup> Jorge L. Quijano, presentation at the Center for Strategic and International Studies, Washington, D.C., May 20, 2015.

<sup>443</sup> Joseph Biden (speech, Panama City, Panama, November 19, 2013).

<sup>444</sup> McMillan, Robert R., *Global Passage: Transformation of Panama and the Panama Canal* (Charleston, S.C.: BookSurge Publishing, 2009), p. 10.

<sup>445</sup> Senior administration official, background conference call on Vice President Joseph Biden’s trip to Panama, November 15, 2013.

<sup>446</sup> Bigler 2015.

Panamanians killed in 1964 protesting the U.S. presence in Panama, including Ascanio Arosemena, the first to die in the violence.<sup>447</sup> Inside the building, however, the corridor outside the Panama Canal library is lined with portraits of former U.S. canal administrators. The Panama Canal Authority regularly celebrates historical milestones that highlight the U.S. canal era, including the canal centennial in 2014. At the base of the canal Administration Building's grand staircase, a marble monument to Goethals, the Panama Canal builder, still stands, dedicated by "his fellow Americans." Quijano, the canal CEO, calls Goethals one of his personal heroes.<sup>448</sup>

### **U.S. Transition: Obstacles in Panama's Path**

For all that ancestral veneration, however, many in Panama insist the United States set up Panama to fail. Though overblown, these critiques do cast doubt on a pure path dependency explanation for Panama's successful canal management.

Critics of the United States point to deep flaws in the U.S.-led transition to Panamanian canal ownership. The signing and ratification of the canal treaties in 1977 sparked celebrations throughout Panama, and hopes for a brighter future for the long suffering country. But the flawed legislation the U.S. Congress produced to implement the Panama Canal treaties – the Panama Canal Act of 1979 – hobbled the transition from the start. Most damaging was the controversial decision by U.S. lawmakers to convert the Panama Canal Company into an appropriated federal agency. That politicized the newly

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<sup>447</sup> The canal authority inaugurated the memorial in 2003 as part of Panama's centennial celebrations. Its rotunda is held aloft by 21 columns bearing the names of the dead. In 2008, the authority added an eternal flame to the memorial.

<sup>448</sup> Community Television Foundation of South Florida, "Panama Canal, Post Panamax," 2015.

established U.S.-led Panama Canal Commission<sup>449</sup> and deprived it of both its independence and the competitive pressures that strengthen self-funding government entities. The Arthur Anderson report put it bluntly: The financial structures of an appropriated agency “are a serious handicap to the commission’s need to evolve a set of financial management practices and procedures that will facilitate the transition and that could be adopted by the post-1999 canal organization.”<sup>450</sup> The implementing legislation also eroded Panama’s confidence that the United States had Panama’s best interests at heart.<sup>451</sup>

On paper at least, the new canal organization was a U.S.-Panama operation. As discussed, the Panama Canal Treaty dismantled the U.S. government’s Panama Canal Company and replaced it with the binational Panama Canal Commission. In an earlier era, a handful of Zonian families had dominated the canal administration, according to longtime Panamanian canal official Rodolfo R. Sabonge.<sup>452</sup> These “guardians of the canal” populated the administration’s upper ranks with their fellow graduates of Balboa High School and the private St. Mary’s School in the canal zone. (In the early years, Panama Canal division chiefs supposedly made hiring decisions based on an applicant’s

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<sup>449</sup> In a January 23, 1979 memorandum to President Jimmy Carter, Secretary of State Cyrus Vance warned that “abandonment of the corporate form could politicize the operation of the canal, through annual debates in Congress, and might lead to efforts by the shipping industry to keep toll rates uneconomically low.” The document is archived at the Jimmy Carter Presidential Library and Museum in Atlanta, Ga.

<sup>450</sup> Arthur Anderson 1993, p. 31.

<sup>451</sup> In a September 18, 1979 memorandum to Vice President Walter Mondale, regarding Mondale’s planned October 7, 1979 visit to Panama, Secretary of State Cyrus Vance said the handling of the implementing legislation “shook Panamanian confidence in our ability to carry out our international commitments in good faith.” An earlier memorandum from Vance to Mondale, dated August 14, 1979, had a similar theme: the trip, he wrote, would “demonstrate that what is happening is not a forced U.S. withdrawal, but the beginning of a new partnership in running the canal.” Both documents are archived at the Jimmy Carter Presidential Library and Museum in Atlanta, Ga.

<sup>452</sup> Ibid., p. 48.



baseball skills,<sup>453</sup> and every office was “overstaffed with cast-off mistresses, poor relatives and the children of friends.”<sup>454</sup>) By contrast, the Panama Canal Commission was designed to share responsibility for canal management with Panama for the first time. Its nine-member board comprised five U.S. nationals and four Panamanians. Flags of both nations flew side by side at all public buildings in the former canal zone.<sup>455</sup> For the first time, Panamanians walked into the Administration Building as equals. “For Panamanians, it was like the White House,” Fernando Cardoze, who served twice on the Panama Canal Commission board (1983 to 1985, 1995 to 1999), recalled. The canal administrator remained a U.S. national, but he now had a Panamanian deputy. (As mandated by the treaties, in 1990, the two would swap positions.) The commission’s annual reports now included a section on treaty implementation and highlighted the growing percentage of Panamanians in the canal workforce.

In practice, however, U.S. nationals continued to control the waterway throughout the transition to Panamanian control. The U.S. president still stood atop the canal’s organizational chart, running the canal through his defense secretary, who in turn deputized the secretary of the Army. The four Panamanian board members required a U.S. presidential appointment. For the United States, mentoring Panamanians was not always a top priority, at least in the early years of the transition.<sup>456</sup> “The canal, still gringo, didn’t think the transition was part of its responsibilities,” Jorge L. Quijano, now the Panama Canal Authority administrator, recalled.<sup>457</sup> Former Panamanian President

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<sup>453</sup> Mary Knapp and Herbert Knapp, *Red, White and Blue Paradise: The American Canal Zone in Panama* (San Diego, Calif.: Harcourt 1984), p. 110.

<sup>454</sup> *Ibid.*, p. 150.

<sup>455</sup> Jorge Ritter, “A Tale of Two Flags: The Last Hurdle,” *ReVista*, Spring 2013.

<sup>456</sup> Suárez 2010, p. 30.

<sup>457</sup> Porras 2007, p. 67.

Ernesto Pérez Balladares (1994 to 1999) made a similar observation. “There was a lot of resistance,” he said. “They were seeing that the end of their paradise was coming. Of course they tried to stop things, to derail things, to get them slowed down.”<sup>458</sup> Rebellious Zonian graffiti declared the Panama Canal Zone the “51st state forever.”<sup>459</sup> The day the canal treaties entered into force – October 1, 1979 – the United States had handed over 600 square miles of the Panama Canal Zone, including 14 former U.S. military bases; ports; the historic Panama Canal Railroad; 7,000 structures; and thousands of pieces of equipment and vehicles. In all, the property was worth \$1.7 billion, not adjusting for inflation.<sup>460</sup> Nevertheless, there was so much mistrust that many Panamanians still doubted that the United States would ever turn over the actual canal.<sup>461</sup>

In 2003 and 2004, Panamanian historian Ana Elena Porras interviewed Panamanians who had participated in the canal transition. Treaty negotiators had designed the two-decade period between the signing of the treaties and the canal turnover as an extended apprenticeship for Panama. The official U.S. goal was to meet its obligation to turn over the canal “in good running order, free of debt and with a skilled workforce capable of operating and maintaining the canal.”<sup>462</sup> As it turned out, Porras found in her interviews, the transition process was marred by U.S. indifference, obstructionism and even bigotry. Critics had long charged the United States with marginalizing Panamanians in the Panama Canal Zone. The United States, as the author Jean Gilbreath Niemeier noted in 1968, “has alternately played proud papa and heavy

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<sup>458</sup> Community Television Foundation of South Florida, “Panama Canal, Prized Possession,” 2015.

<sup>459</sup> Roberto Emerick quoted in Porras 2007, p. 115.

<sup>460</sup> Suárez 2010, p. 15.

<sup>461</sup> Community Television Foundation of South Florida 2015.

<sup>462</sup> Arthur Anderson 1993), p. 1.

father, but never patient instructor.”<sup>463</sup> That changed to some degree under U.S. President Jimmy Carter, but the momentum that led to Carter’s treaties was exhausted by the time the Senate had ratified the treaties.<sup>464</sup> As a result, little occurred during the initial years of the transition. Few Panamanians doubted Carter’s good will, but they regarded his two-term successor, U.S. President Ronald Reagan (1981 to 1989), as a “mortal enemy” of the canal turnover.<sup>465</sup> Sabonge, who directed the Panama Canal Commission’s transition division, had no budget and an isolated office. The “canal establishment,” he said, remained “an enormous obstacle.”<sup>466</sup> The United States boasted of “an exceptional esprit de corps”<sup>467</sup> in the U.S.-led Panama Canal Commission. To Alemán, however, it felt like “apartheid.”<sup>468</sup> In the later phase of the transition, the deputy canal administrator, Raymond Lavery, technically served under Alemán. But Sabonge accused Lavery of “sabotaging the transition,”<sup>469</sup> keeping information from his Panamanian boss, whom he “treated like the enemy.”<sup>470</sup> Agustín Alberto Arias, a canal engineer, agreed. During Lavery’s tenure,<sup>471</sup> he said, the canal leadership remained “hermetically sealed to Panamanians.”<sup>472</sup> Ricaurte Vásquez, the canal’s first Panamanian chief financial officer, had to fight to occupy the house traditionally reserved for his position. His predecessor

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<sup>463</sup> Niemeier, Jean Gilbreath, *The Panama Story* (Dallas, Texas: Metropolitan Press, 1968), p. 261.

<sup>464</sup> Carter seemed to believe that the Zonians were not on board with his plan to execute a smooth canal turnover. In a visit to the Panama Canal Zone after he signed the treaties, he reminded the Zonians, “I am relying on all of you to help make this transition as smooth as possible. That is your duty, your responsibility and the people of both nations expect nothing less.”

<sup>465</sup> Suárez 2010, p. 29.

<sup>466</sup> Porras 2007, p. 53.

<sup>467</sup> Panama Canal Commission Administrator Dennis P. McAuliffe, writing in the Panama Canal Commission’s 1987 Annual Report.

<sup>468</sup> Porras 2007, p. 207.

<sup>469</sup> Ibid., p. 74.

<sup>470</sup> Ibid., p. 57.

<sup>471</sup> Wainio defends Lavery’s leadership, but for Panamanians, Lavery’s name is radioactive. Suárez, in his official history of the canal’s first decade under Panamanian control, says Lavery had “the same disruptive mentality of the establishment Zonians.” Lavery died in 1996.

<sup>472</sup> McAuliffe 1987, p. 85.

spent just half an hour briefing him for the job.<sup>473</sup> Gene Bigler, who served as the “canal watcher” at the U.S. Embassy in Panama City immediately after the canal’s handover to Panama, gives the U.S. government no credit for Panama’s success. “There had been neglect on the part of the United States,” he said. “The United States did not make a great effort for Panama to succeed.”<sup>474</sup>

The transition also suffered from the U.S.-led Panama Canal Commission’s apparent indifference to the long-term health of canal infrastructure. Panamanians who participated in the transition process say the United States planed to hand over a creaking and obsolete waterway. Despite intense lobbying by Panamanian officials, U.S. authorities resisted increasing tolls to pay for infrastructure upgrades.<sup>475</sup> “We felt the Americans did not want to invest in a canal they were going to hand over to Panama,” Quijano said.<sup>476</sup>

It was in these circumstances that Panamanians, for the first time, played a decisive role in canal management. Meeting in secret, they decided to persuade the U.S. government to acknowledge the canal’s physical deterioration, and to do something about it. These Panamanians, led by Roberto Roy – who would later serve as chairman of the Panama Canal Authority Board of Directors – and Moisés Catillo, Alberto Palacios and Ernesto Ng – set up a Blue Ribbon Engineering Committee to diagnose the canal’s vulnerabilities. “The gringos would have given us the keys to a dilapidated, ancient canal,” Sabonge said.<sup>477</sup> “The best kept secret” of the canal, he said, was “the magnitude

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<sup>473</sup> Porras 2007, p. 128.

<sup>474</sup> Interview by author with Gene Bigler, May 11, 2015.

<sup>475</sup> Bigler 2015.

<sup>476</sup> Porras 2007, p. 66.

<sup>477</sup> Ibid., p. 69.

of its decrepitude.”<sup>478</sup> Carlos Ernesto González de la Lastra, of the Asociación Panameña de Ejecutivos de Empresa, logged 1,001 problems requiring urgent attention. The United States, he said, planned to hand over a “mountain of scrap.”<sup>479</sup> Some Panamanians saw a conspiracy in the canal’s cracks and rust: the United States was setting up Panama to fail in order to justify a U.S. invasion retaking the waterway.<sup>480481</sup>

Following its preliminary investigation, the Blue Ribbon Engineering Committee demanded that U.S. canal authorities commission an outside audit.<sup>482</sup> U.S. authorities rejected requests to hire independent French or Swedish inspectors, according to Cardoze, the former Panama Canal Commission board member. However, the United States did agree to hire the U.S. Army Corps of Engineers to take a careful look at the canal that Panama stood to inherit. Initially, Panamanians doubted the objectivity of a U.S. government review, and the Blue Ribbon Engineering Committee insisted on continuing its own inspections. “We visited every nook and cranny,” Roy said.<sup>483</sup> Ultimately, however, the Panamanians were pleased by the findings of the Army Corps of Engineers. Alemán – the future canal administrator who led the Blue Ribbon Engineering Committee – blessed the Army Corps of Engineers study. Following its report, the U.S.-led Panama Canal Commission began pouring money into the waterway. In 1995, the commission approved a “milestone plan” including 200 transition-related tasks; changed the name of the Office of Executive Planning to the Office of Executive Planning *and Transition Coordination* (emphasis added); and added a division focused

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<sup>478</sup> Ibid., p. 70.

<sup>479</sup> Ibid., p. 188.

<sup>480</sup> Jorge Quijano quote in Porras 2007, p. 77.

<sup>481</sup> Suárez 2010, p. 33.

<sup>482</sup> Interview by author with Roberto Roy, Panama City, Panama, August 26, 2013.

<sup>483</sup> Community Television Foundation of South Florida 2015.

exclusively on transition affairs.<sup>484</sup> In 1997, the United States began replacing the locomotives that pull ships through the canal locks, upgrading the rails for the locomotives and widening the Culebra Cut, the narrowest stretch of the waterway. Annual spending on capital improvements rocketed from an average of \$30 million in the 1980s to \$100 million.<sup>485</sup> The commission's board adopted a long-term transition plan that forecast \$1 billion in capital investments.<sup>486</sup>

### **Manuel Noriega, the U.S. 'Pineapple' Partner**

Undoubtedly, Panama was also to blame for disrupting the historic transition to Panamanian canal management. Sure, Omar Torrijos had his faults; a military ruler, he had little respect for human rights or civil liberties. He silenced opposition voices, banned political parties and suffocated Panama's news media. For the canal, however, Torrijos's constructive relationship with the White House might have helped keep the transition on a steady course. As it turned out, however, two years into the transition, Torrijos died when his Panamanian Air Force plane crashed in stormy weather on August 1, 1981.<sup>487</sup> Noriega, Torrijos's successor and former intelligence chief, was decidedly less

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<sup>484</sup> Panama Canal Commission, "Annual Report," 1995.

<sup>485</sup> *Ibid.*, p. 82.

<sup>486</sup> U.S. canal officials who supervised the early years of the transition tend to minimize the importance of the Blue Ribbon Engineering Committee, and reject the notion that the United States ever skimmed on canal upkeep. They point to capital investments that predated the Blue Ribbon Engineering Committee's establishment and the Army Corps of Engineers study, such as locomotive and tug boat replacements and an earlier widening of the Culebra Cut. Indeed, an official progress report on the first 10 years of the canal transition catalogued a series of costly maintenance projects and infrastructure upgrades, including the installation of high-mast lighting at the locks; the purchase of high-speed launches to transport canal pilots to transiting ships; and lock overhauls that cost \$5 million a year. "The Panama Canal was always well maintained," Wainio said in an interview with the author. "Our goal was to turn over to Panama a canal that was in good working order." He dismissed as ludicrous and illogical any suggestion to the contrary. "It is such nonsense. It is beyond me how anyone with half a brain in their head could think that way.... We knew that post-2000, the United States would be far and away the biggest user of the Panama Canal. We had a clear incentive to do everything we could possibly do to make sure it runs well.... The transition was our life. You think we were going to undermine it? We knew who would get blamed if it failed."

<sup>487</sup> Saxon, Wolfgang, "Panama Leader Killed in Crash in Bad Weather," *United Press International*, August 2, 1981.

committed to a smooth canal transition. From the start, Noriega, deeply corrupt and violent, did not share the U.S. vision of a civilian-run canal. Rather, he preferred to replicate the Pentagon's dominance of the waterway. "For Noriega, the only thing you had to change was to install a Panamanian general in place of an American general. That was Noriega's mindset. And that Panamanian general was himself."<sup>488</sup> Noriega also lacked Torrijos's capacity to charm U.S. officials, despite Noriega's long history of ties to the Central Intelligence Agency, the U.S. Department of Defense and the U.S. Drug Enforcement Administration.<sup>489</sup>

For a time, U.S. officials were able to stomach Noriega because Nicolás Ardito Barletta – the country's figurehead president, who had narrowly won (or perhaps narrowly stole) the 1984 election – had the type of resume admired in Washington. A University of Chicago-trained economist, Barletta held positions at the World Bank and the Organization of American States. But Barletta suddenly resigned just a year into his term – on September 28, 1985 – after clashing with his military overseers. His abrupt departure – he announced it in a statement at 2:30 a.m.<sup>490</sup> – elevated to the presidency Barletta's vice president, Eric Arturo Delvalle, a respected industrialist. The United States warily accepted the personnel change. But the U.S.-Panama relationship, never cordial or cooperative under Noriega, worsened significantly in 1988, after Noriega deposed Delvalle.<sup>491</sup> Like Panama's civilian leaders under Torrijos, Delvalle had held limited authority. But Delvalle, like Barletta, was respected by U.S. officials, and his

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<sup>488</sup> Lewis 2013.

<sup>489</sup> John Dinges's *Our Man in Panama: How General Noriega Used the United States, and Made Millions in Drugs and Arms* (New York City, N.Y.: Random House, 1990) offers a good history of Noriega's controversial relationship with the U.S. government.

<sup>490</sup> "New President Takes Office in Panama," *United Press International*, September 28, 1985.

<sup>491</sup> Chapter 5 includes greater detail about Panamanian political developments in this critical period.

ouster caused relations between the two governments to deteriorate rapidly. As Panama morphed into a narco-state, senior U.S. officials began debating the best way to remove Noriega. Members of Reagan's National Security Council fought bitterly over a proposal – ultimately supported by Reagan, over Vice President George H.W. Bush's strong objections – to drop U.S. drug trafficking charges against Noriega in return for his retirement from Panamanian politics.<sup>492</sup> Noriega, however, rejected the offer, and Reagan left the Panama dilemma to his successor. It would become one of the “most pressing problems” Bush inherited.<sup>493</sup> As president, Bush (1989 to 1993) continued to oppose dropping criminal charges against Noriega. So with the future of the canal hanging in the balance, Bush sought other ways to resolve the standoff, including a scheme to arrest Noriega should he set foot inside the Panama Canal Zone,<sup>494</sup> as well as support for Panamanian coup plotters.<sup>495</sup>

Throughout the calamitous Noriega era,<sup>496</sup> the United States never suspended canal transition activities. In some ways, in fact, the process accelerated; an increased exodus of U.S. canal workers compelled heightened efforts to recruit and train Panamanian replacements.<sup>497</sup> The U.S. government deprived Noriega of his right, under the treaties, to appoint a Panamanian to serve as the canal administrator starting on January 1, 1990. But the United States did not keep McAuliffe in place; instead, it promoted Fernando Manfredo, the Panamanian deputy canal administrator, to acting administrator. At the time, The New York Times reported that a “historic watershed has

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<sup>492</sup> James A. Baker, *The Politics of Diplomacy: Revolution, War and Peace, 1989-1992* (Grand Haven, Mich.: Brilliance Corporation, 1995), p. 180.

<sup>493</sup> Ibid.

<sup>494</sup> Ibid., p. 182.

<sup>495</sup> Ibid., p. 185.

<sup>496</sup> Though Noriega was a fearsome figure as Omar Torrijos's intelligence chief and later Panama's military dictator, his misshapen complexion earned him a goofy nickname, “pineapple face.”

<sup>497</sup> Interview by author with Joseph Wood, May 11, 2015.



passed without fanfare.”<sup>498</sup> The administrative shuffle clearly advertised the U.S. commitment to keep the transition advancing,<sup>499</sup> despite the Panamanian political tumult,<sup>500</sup> and it helped the United States avoid a distracting “regional firestorm”<sup>501</sup> over noncompliance with the treaty. (The United States had sworn-in Manfredo as deputy administrator on October 1, 1979, the day the Panama Canal treaties originally took effect. He served as interim administrator until September 20, 1990, when the United States swore-in Gilberto Guardia as the first permanent Panamanian administrator.) As discussed, even in the years directly before the 1989 U.S. invasion of Panama (which will be addressed in depth), U.S. canal authorities continued to invest in the canal, installing the high-mast lighting to improve nighttime visibility and adding buoys and beacons to ease navigation.<sup>502</sup>

Undoubtedly, however, Noriega had “dealt a blow” to the process.<sup>503</sup> U.S. investment in the canal declined. Panama made no serious attempt at administrative preparations. The U.S. military slowed land transfers. The U.S.-led Panama Canal Commission board struggled to function; from 1987 to 1990, the United States denied visas to the four Panamanian board members, who could no longer attend board meetings in the United States.<sup>504</sup> When the board convened in Panama, Noriega’s combative appointees sapped productivity.<sup>505</sup> Bilateral cooperation stalled. Due to U.S. economic

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<sup>498</sup> Rohter, Larry, “Panamanian Runs the Canal: A First,” *The New York Times*, January 3, 1990.

<sup>499</sup> “In the tumult surrounding the American military invasion of Panama and the overthrow of Gen. Manuel Antonio Noriega, one historic watershed has passed without fanfare: For the first time in its 75-year history, the Panama Canal is now being run by a Panamanian,” *The New York Times* reported.

<sup>500</sup> The Bush administration spokesman, Marlin Fitzwater, in a statement on December 5, 1989, justified that decision by arguing that “no legitimate government authority exists in Panama.”

<sup>501</sup> Baker 1995, p. 184.

<sup>502</sup> Maurer 2010, p. 299.

<sup>503</sup> Sabonge quoted in Porras 2007, p. 51.

<sup>504</sup> Suárez 2010, p. 32.

<sup>505</sup> McMillan 2009, p. 19.

sanctions on Panama, the Panama Canal Commission withheld the payroll taxes it collected from its Panamanian employees. In retribution, Noriega denied license plates to these Panamanians, and the canal authority had to lease buses and high-speed launches for their commutes to the canal. “It was not the best atmosphere,” Pérez Balladares, the former president, said.<sup>506</sup> For the canal, as in so many areas of Panamanian life, the Noriega era was a lost decade. Afterward, canal planners continued to suffer from Noriega’s procrastination, forced to run the canal transition “like cramming for an exam the night before.”<sup>507</sup> Noriega’s “most important legacy was one of inaction on vital canal-transition issues,” Robert R. McMillan, a former chairman of the U.S.-led Panama Canal Commission board, recalled. “From ratification of the Carter-Torrijos treaty in 1978, very few steps had been taken by Panama to be ready for operation of the canal at the end of the century.”<sup>508</sup>

For U.S. nationals in Panama, it was “a tough time to continue to operate the canal successfully and move the treaty forward.”<sup>509</sup> Noriega’s operatives surveilled senior canal officials, taking their photographs through car windows.<sup>510</sup> A strike by anti-Noriega port workers in Balboa involved a barricade of shipping containers that trapped U.S. canal workers in their homes.<sup>511</sup> Amid the tension, the United States shipped dependents of U.S. canal workers back to the United States.<sup>512</sup> In 1989, McAuliffe, in his last year as canal administrator, pleaded for a resolution to Panama’s domestic chaos and its conflict with the United States.

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<sup>506</sup> *Panama Canal: Prized Possession* (Miami, Fla.: WPBT2, Community Television Foundation of South Florida, 2015).

<sup>507</sup> Lewis 2013.

<sup>508</sup> McMillan 2009, p. 43.

<sup>509</sup> Interview by author with Richard Wainio, September 2, 2014.

<sup>510</sup> Interview by author with Richard Morgan, May 11, 2015.

<sup>511</sup> Interview by author with Joseph Wood, May 11, 2015.

<sup>512</sup> McMillan 2009, p. 21.

“The political crisis in Panama, which has been impinging on relations between Panama and the United States for more than two years, continued to intensify. This condition had a serious adverse impact on the morale of the canal workforce, and provoked broad concern for the safe and efficient operation of the waterway. A variety of contingency measures were temporarily invoked to ensure the normal flow of canal traffic. Nevertheless, it is imperative that the political situation be effectively resolved.”<sup>513</sup>

On December 20, 1989, the United States invaded Panama to depose Noriega, in part because his leadership had endangered the future operation of the canal.<sup>514</sup> “There was this gnawing concern,” James A. Baker III, the U.S. secretary of state at the time, recalled.<sup>515</sup> “We were worried about the transfer of the canal to a Panama ruled by a thug.” Clearly, the United States had other motivations for the invasion. U.S. authorities had indicted Noriega on charges of drug trafficking, and Bush had publicly called drugs “the gravest domestic threat facing our nation.”<sup>516</sup> There were other law enforcement goals, too.<sup>517</sup> Noriega was involved in arms trafficking and money laundering. The United States also described the invasion of Panama as a defense of democracy, emphasizing Noriega’s manipulation of the 1989 presidential election. In terms of foreign policy considerations, the U.S. government saw Noriega as an impediment to its regional counternarcotics efforts,<sup>518</sup> and accused him of supporting leftist guerrillas in El Salvador and Nicaragua;<sup>519</sup> at the State Department, he was seen as the “Muammar el-Qaddafi of

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<sup>513</sup> Panama Canal Commission, “Annual Report,” 1989.

<sup>514</sup> In the Marquis “Who’s Who” biographical database, the sole note in the “achievements” category for Noriega is his overthrow by U.S. forces.

<sup>515</sup> Interview by author with James A. Baker III, October 31, 2014. President George H.W. Bush appointed Baker secretary of state on January 22, 1989, and he served until August 23, 1992.

<sup>516</sup> Eytan Gilboa, “The Panama Invasion Revisited: Lessons for the Use of Force in the Post Cold War Era,” *Political Science Quarterly* Vol. 110, No. 4 (1995): 539.

<sup>517</sup> In a press conference on December 21, 1989, President Bush George H.W. Bush called Noriega a “fugitive drug dealer”; said U.S. authorities “want to see him brought to justice”; and announced a \$1 million bounty for his capture, according to a transcript posted on the Bush presidential library Web site, <http://bush41.org/>.

<sup>518</sup> Baker 1995, p. 178.

<sup>519</sup> Ibid., p. 184.

Latin America.”<sup>520</sup> U.S. authorities, moreover, were deeply disturbed by Panama’s treatment of U.S. personnel who circulated outside the canal zone. There were 35,000 U.S. citizens in Panama in those days and Noriega’s harassment – as well as his ill-advised declaration of war against the United States – permitted U.S. officials to argue that the invasion was in self-defense and therefore permitted under international law. On December 16, 1989, Panamanian soldiers shot and killed an unarmed U.S. Marine, Lieutenant Robert Paz, and separately, detained a U.S. Navy officer, Lieutenant Adam J. Curtis, and his wife, Bonnie, beating Curtis and sexually threatening his wife. “We could not sit back and stand for a dictator like that treating our people that way,” Baker said. U.S. impatience and disgust with Noriega – “a case of what we in Texas call ‘bad chili,’” as Baker wrote in his memoir<sup>521</sup> – was another factor in the U.S. decision to invade. Finally, there was the public image of the president, who was seen as timid, despite his service as a Navy pilot, including 58 combat missions during World War Two.<sup>522</sup>

Still, Panama’s future administration of the canal was a major preoccupation for U.S. policymakers.<sup>523</sup> Noriega steadfastly refused to leave office, and senior U.S. officials dreaded the prospect of turning over the canal to his brutish and incompetent government.<sup>524</sup> By then, it was clear Noriega was putting the Panama Defense Force in charge of treaty implementation. It was also the Panamanian military that seized reverted U.S. properties from the former Panama Canal Zone.<sup>525</sup> “It was a nagging doubt,” Baker said. “We couldn’t trust this guy to comply with his treaty obligations. Who knows how

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<sup>520</sup> Ibid.

<sup>521</sup> Ibid., p. 177.

<sup>522</sup> Naftali, Timothy J., *George H.W. Bush* (New York City, N.Y.: Times Books, 2007), p. 88.

<sup>523</sup> Maurer 2010, p. 9.

<sup>524</sup> Sánchez, Peter M., *Panama Lost? U.S. Hegemony, Democracy and the Canal* (Gainesville, Fla.: University Press of Florida, 2007), p. 174.

<sup>525</sup> Ibid., p. 168.

it might have been run if we had not done what we did?” On December 17, 1989, following a White House Christmas Party, Bush assembled his senior advisers – including Defense Secretary Dick Cheney, Chairman of the Joint Chiefs of Staff Colin Powell and National Security Adviser Brent Scowcroft – and announced his decision to go to war.<sup>526</sup> A short time later, publicly announcing the invasion, Bush said he was acting to “protect the integrity of the Panama Canal treaty.” The United States, he said in his 7:20 a.m. nationally televised address from the Oval Office, was “fully committed to implement the Panama Canal treaties and turn over the canal to Panama in the year 2000. The actions we have taken and the cooperation of a new, democratic government in Panama will permit us to honor these commitments.” Reflecting on the invasion, Baker said Noriega’s dictatorship “threatened the transfer of the canal to Panamanian sovereignty.”<sup>527</sup> “One way or another, Noriega’s rule had to end,” he had concluded.

The Panama invasion was the first major use of U.S. troops since Vietnam.<sup>528</sup> Ultimately, Noriega’s removal proved to be a blessing for Panama and its canal. The U.S. had eliminated the bullying Panama Defense Force as a political actor.<sup>529</sup> (Later, under President Guillermo Endara, Panama would disband its armed forces once and for all.) The canal itself emerged unharmed; during the fighting, U.S. paratroopers stood guard at Madden Dam.<sup>530</sup> After staying up until 4 a.m. the night of the invasion, Bush held a press conference the next morning and reassured his U.S. audience that their Panama Canal was safe.<sup>531</sup> In the short term, however, the invasion did no favors to canal operations or

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<sup>526</sup> Ibid., p. 189.

<sup>527</sup> Ibid., p. 178.

<sup>528</sup> Gilboa 1995, p. 539.

<sup>529</sup> Sánchez 2007, p. 173.

<sup>530</sup> McMillan 2009, p. 32.

<sup>531</sup> Parment, Herbert S., *George Bush, The Life of a Lone Star Yankee* (New York City, N.Y.: Scribner, 1997), p. 418.

the transition to Panamanian management. During the fighting, much of the violence occurred close to the canal in Panama City, where Noriega maintained his urban headquarters. Mortar and machine gun fire echoed throughout the Panamanian capital as U.S. troops sought Noriega's capture.<sup>532</sup> Before the invasion, a Panamanian military officer had handed Richard Morgan, who supervised the canal's land-based activities, a list of 20 Panama Canal Commission officials that Panamanian special forces – patrolling in Toyota Land Cruisers – planned to kidnap in the event of war with the United States. As promised, on the night of the invasion, eight Panamanian soldiers approached Morgan's house on Ancón Hill. "They came to get me," he said, "they came out of the jungle."<sup>533</sup> Morgan, who spent 25 years living and working at the canal, transiting the waterway 125 times, suddenly found himself a prisoner in his home. That night, he watched members of the U.S. 82nd Airborne Division repel the Panamanians attackers. In the morning, he saw them collect corpses and shell casings from his backyard. Wainio, also on Noriega's hit list, received a telephone message as the fighting broke out with the code word "Hammerblow" and instructions to turn off his lights and close his drapes. Like Morgan, he was soon trapped in his house, surrounded by U.S. troops.<sup>534</sup> For 12 hours, the canal shut down, reopening on a daylight schedule on December 21, 1989.<sup>535</sup>

### **Panama's Turn: The Final Decade**

Following the U.S. invasion, canal transition efforts ramped up, and even most Panamanians admit the U.S. attitude improved. The new Panama Canal Commission

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<sup>532</sup> Gordon, Michael R., "U.S. Troops Move in Panama in Effort to Seize Noriega; Gunfire is Heard in Capital," *The New York Times*, December 20, 1989.

<sup>533</sup> Interview by author with Richard Morgan, May 11, 2015.

<sup>534</sup> WPBT2, Community Television Foundation of South Florida 2015.

<sup>535</sup> "Canal Resumes Operations Following U.S. Military Action," *Spillway*, December 29, 1989.

board chairman, Joseph Reeder, rapidly won over the canal's senior Panamanian officials. At board meetings, he did away with the tradition of sitting Panamanian and U.S. board members on opposite sides of the conference table. To ease the transformation to Panamanian governance, he accommodated Panama's desire for a for-profit management style. "You're passing the baton," Reeder said.<sup>536</sup> Reeder had two advantages over his predecessors: the canal was now free of Noriega's meddling,<sup>537</sup> and a skilled Panamanian workforce had emerged from a decade of U.S. tutelage. Still, Reeder's attitude helped a great deal, restoring Panamanian confidence in the U.S. commitment to the canal transition and recouping the lost mojo in the bilateral relationship. Panamanian canal officials can still recite Reeder's slogan – "one team, one mission"<sup>538</sup> – and Reeder's dream of a "seamless transition."

So how, then, did Panama pull it off? No single explanation is sufficient. The canal transition, as discussed at length, did not exactly give Panama a running start. From the beginning, it was marred by mistrust. Later, Noriega's shenanigans and the disruptive U.S. invasion hardly helped advance the process. Since the euphoria of the Carter-Torrijos treaties, Panama had seen its dashing dictator die in a plane crash, its drug-running dictator deposed and captured, and foreign troops overrun its capital. Just a decade before the turnover would take place, Panamanian society remained deeply divided, its economy a shambles and its public institutions beaten down by decades of military dictatorship and a war.

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<sup>536</sup> Ibid.

<sup>537</sup> Old U.S. canal hands regard Noriega's removal as perhaps the greatest gift the United States ever gave Panama. "Jimmy Carter got awfully lucky," Richard Morgan said in an interview with the author. "I don't think the canal would be open today if it had stayed on that same path." Carter, who opposed the invasion, acknowledged sharing concerns over putting the canal in Noriega's hands. "I never had any confidence in Noriega," he said in an interview with the author.

<sup>538</sup> Interview by author with Manuel E. Benítez, Panama City, Panama, August 5, 2013.

Even a perfect canal transition would not have guaranteed Panama's success. The canal, after all, is not a foolproof operation, and Panama would have ample opportunity to gum up the works. As Panamanians like to say, the canal was passing from a superpower to a third world country, from its top user to a non-user. The flawed handover further handicapped Panama. Yet to the surprise of practically all observers – not least of which the legions of critics of the canal treaties – Panama has avoided the pitfalls that bedevil most state-owned enterprises and masterfully managed the Panama Canal.

There is no consensus on exactly how Panama managed to exceed all expectations. Many analysts, in the United States and Panama, are satisfied with versions of the “golden goose” and “too-big-too-fail,” explanations:<sup>539</sup> the canal was simply too valuable an asset to mishandle.<sup>540</sup> According to this popular hypothesis, Panamanian elites protect the canal because the country fears the loss of the canal's annual dividends; relies upon the canal's economic linkages; and credits the canal's squeaky clean brand with attracting foreign direct investment to Panama. Indeed, from the start of Panamanian canal management, Panamanians feared that failure would lead to economic calamity and the potential return of U.S. troops to the Panama Canal or Panamanian troops to Panama's presidential palace. Cardoze, the three-time Panama Canal board member, said the canal succeeds because it is “paramount” to Panama's economy.<sup>541</sup> Christopher L. Koch, president of the World Shipping Council,

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<sup>539</sup> Sometimes, the animal metaphor changes, though the analysis is identical. “You don't kill the cash cow,” Antonio Domínguez Álvarez, the canal's inspector general, told the author on August 21, 2013.

<sup>540</sup> President Jimmy Carter appeared to accept this explanation. In a speech on February 1, 1978, he said of the Panama Canal: “To Panama it is crucial. Much of her economy flows directly or indirectly from the canal. Panama would be no more likely to neglect or close the canal than we would be to close the interstate highway system here in the United States.”

<sup>541</sup> Interview by author with Fernando Cardoze, Panama City, Panama, August 14, 2013.



summed up Panama's attitude this way: "Don't screw up a good thing."<sup>542</sup> Robert A. Pastor, Carter's top Latin America adviser, said Panamanians "understood from the very beginning that their future depended on the Panama Canal."<sup>543</sup> "Nobody," he said, "wanted to do anything that could kill the golden goose." The canal was so important to Panama, explained Peter F. Romero, the U.S. assistant secretary of state for Western Hemisphere affairs at the time of the canal turnover, that Panama did not dare destroy it. "This was way too important for too many Panamanians," he said.<sup>544</sup> "There was a strong sense that this was their chance, this was their moment, and that was stronger than their historic venality." Michael Klein, an expert on infrastructure policy and regulation at Johns Hopkins University, said he had seen other "Little Engine that Could" stories. "Pretty terrible governments are capable of pulling themselves together if it's a lifeline," he said.

Other canal observers cite a corollary to the "golden goose" argument: the if-it-ain't-broke-don't-fix-it hypothesis. The canal's strong performance, they argue, creates a virtuous circle that permanently protects the canal operation. "Its success protects the model," Arias, Panama's former foreign minister, said. In a country where tax revenue is just 19 percent of GDP<sup>545</sup> – compared to an average of 34 percent in the Organization for Economic Cooperation and Development,<sup>546</sup> and 21 percent in Latin America – the canal's \$1 billion annual dividend to Panama's national treasury is hardly a rounding

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<sup>542</sup> Interview by author with Christopher L. Koch, September 5, 2014.

<sup>543</sup> Interview by author with Robert A. Pastor, July 10, 2013. Pastor died on January 8, 2014.

<sup>544</sup> Interview by author with Peter F. Romero, Washington, D.C., July 10, 2014.

<sup>545</sup> "Revenue Statistics in Latin America 1990-2012," Inter-American Center of Tax Administrations, Economic Commission for Latin America and the Caribbean, Organization for Economic Cooperation and Development, and OECD Development Center, 2014.

<sup>546</sup> The Organization for Economic Cooperation and Development (OECD), based in Paris, France, has 34 members, primarily developed countries, but also including Mexico, Chile and Turkey.

error. “You just don’t want to mess with that,” J.P. Morgan’s Franco A. Uccelli said, “that is pretty much the consensus there.”<sup>547</sup>

Others attribute Panama’s success to the symbolic importance of the canal. It is the glue of Panamanian society, as the argument goes, and the fuel for Panamanian nationalism and pride.<sup>548</sup> As with the “golden goose,” “too-big-too-fail” and “if-it-ain’t-broke-don’t-fix-it” hypotheses, it is not clear what causal mechanism is operating here. Still, the Panamanians with the most intimate knowledge of the canal constantly emphasize the canal’s historical and cultural importance to explain its extraordinary performance in Panamanian hands. “There was 100 years of fighting for this,” former Panamanian President Martín Torrijos, Omar Torrijos’s son, said.<sup>549</sup> “There were deaths,” he added, alluding to Panamanian protestors killed by U.S. troops. “It’s an emotional issue for Panama. It is part of the patrimony, more than just infrastructure.” Panamanians regard the canal turnover as a milestone equivalent to the territory’s independence from Spain (1821) and later from Colombia (1903).<sup>550</sup> On Ancón Hill, one plaque commemorates the signing of the Carter-Torrijos canal treaties, while another features a 1954 poem by Demetrio Karsi that begs to know when Panama’s servitude will end. Only two Panamanian holidays can be moved to a Monday to give a three-day weekend, the anniversary of Panama’s independence from Spain and the anniversary of the January 9, 1964 shooting of Panamanian students protesting the U.S. canal administration, known as Martyrs Day. Panama also memorializes those deaths outside its legislative assembly, where a life-sized statue of a lamppost shows three Panamanian

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<sup>547</sup> Interview by author with Franco A. Uccelli, December 2, 2014.

<sup>548</sup> Rodríguez 2014.

<sup>549</sup> Interview by author with Martín Torrijos, Panama City, Panama, January 18, 2013.

<sup>550</sup> I. Roberto Eisenmann Jr., “Panama and the United States, A Love-Hate Relationship,” *ReVista*, Spring 2013.

students climbing to raise the Panamanian flag inside the former Panama Canal Zone. The former Fourth of July Avenue in Panama City is now known as the Avenue of the Martyrs. A major highway along the canal is named for Omar Torrijos, whose image dominates a prominent billboard in Panama City that features the slogan, “Thanks to you, the country realized its dream of freedom.” In downtown Panama City, under the principal viaduct, graffiti commemorates January 9, 1964 with images of students facing a firing squad. On the Avenue of the Martyrs, a wall is painted colorfully with the slogan “un solo territorio.” Cardoze, the former canal board member, called the canal “the religion that united Panamanians of all social strata and political parties.” (U.S. canal negotiator Sol M. Linowitz described the canal as “a bone in the throat of Panamanians, rich or poor, educated or illiterate, across the political spectrum.”<sup>551</sup>) Eduardo Antonio Quirós, the president of two leading Panamanian newspapers, *El Siglo* and *La Estrella*, and a former canal board member, also credits the canal’s symbolic importance for its successful management. “The fight to recover the canal lasted 100 years; it was the major theme of our history,” he said, sitting in his conference room overlooking Ancón Hill, where a gigantic Panamanian flag flies over the treetops in the heart of the once off-limits Panama Canal Zone. The canal, he said, “is like our flag, our national symbol.” Barletta, the former president, said all Panamanians “feel a national responsibility not to fail”<sup>552</sup> in the canal’s administration.

“As Panamanians, we feel at last we have settled our debt to the martyrs, to generations of patriots who fought bravely, patiently and with determination to achieve a grandiose goal – a specific objective, but one that was almost mythical. This secular religion, the nationalism that united us for nearly a century, came to a

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<sup>551</sup> Sol M. Linowitz, *The Making of a Public Man: A Memoir* (Boston, Mass.: Little, Brown 1985), p. 146.

<sup>552</sup> Interview by author with Nicolás Ardito Barletta, Panama City, Panama, August 27, 2013.

climax when we achieved what we thought for years was an impossible dream.”<sup>553</sup>

According to this explanation, a shared sense of mission inspires excellence from within the Panama Canal Authority and prevents meddling from without. “In Panama, you can mess with a lot of things politically, but not the canal,” Lewis, the former vice president and foreign minister, said. “There’s a line in the sand.”<sup>554</sup> Here, Panamanian civil society is said to play a central role, ever vigilant to the potential politicization of the canal or the improper influence of a president or lawmaker.<sup>555</sup> “Tampering with the Panama Canal (or even seeming to tamper with the Panama Canal for political gain) rapidly became the quickest way to lose support among the electorate. As a result, competitive politics led to a new Panama Canal administration that ran the canal much more efficiently and commercially than the United States ever did.”<sup>556</sup> In post-Noriega Panama, “politicians soon discovered that they had to be able to refute charges that they would interfere with canal operations if they were to retain popular support.”<sup>557</sup>

“The canal for us was not only an economic asset to be incorporated to our economy, but something far more deeply rooted in our identity as a nation. From the beginning of the 20th century, many generations fought, and even sacrificed their lives, to make the canal Panama’s patrimony and to correct a historical injustice that gave the United States the right to manage it perpetually. And now that we have achieved the dream of several generations, we are not going to let it fade away.”<sup>558</sup>

Outsiders consistently make a similar observation when explaining how Panama has avoided the widely predicted patronage and corruption at the canal. Observers

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<sup>553</sup> Suárez 2010, p. 14.

<sup>554</sup> Lewis 2013.

<sup>555</sup> Roy 2013.

<sup>556</sup> Maurer 2010, p. 10.

<sup>557</sup> Ibid., p. 302.

<sup>558</sup> Alberto Alemán Zubieta, “The Story That Panama Decided to Write, The Panama Canal Through the Years,” *ReVista*, Spring 2013.

describe the canal as the “third rail” of Panamanian politics.<sup>559</sup> Moody’s Investors Service noted the “evident pride of the average citizen in the operations.”<sup>560</sup> Christopher C. McIsaac, who advised the lenders who are paying for the canal expansion, also pointed to the pride factor in justifying the confidence lenders exhibited in backing the complex and costly expansion. “There is a tremendous amount of national pride in the asset,” he said. “They would not want to see the asset besmirched by over-politicization.”<sup>561</sup> Bigler, the former U.S. Foreign Service Officer in Panama, said Panamanians were determined to outshine the United States. There was a “superhuman effort of the Panamanians to demonstrate their capacity to meet and exceed the U.S. achievement,” he said. “They kept looking for outside standards they could live up to.”<sup>562</sup>

There is no doubt that national pride plays a part in the success of the Panama Canal. Panamanians are aware that great powers rarely give away territory willingly, particularly land as large and strategic as the Panama Canal Zone. The British relinquished Hong Kong to China on July 1, 1997, but steadfastly reject Spain’s claims on Gibraltar and hang on to the remote Falkland Islands despite a war in 1982 and ceaseless protests from Argentina. In the United States, many oppose the repatriation of artifacts to foreign governments, let alone the transfer of territory. (Carter learned that lesson after he followed up on the Panama Canal treaties by returning the Crown of St. Stephen to Hungary on January 6, 1978.<sup>563</sup>) For Panama, the long and bloody struggle to

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<sup>559</sup> Maurer 2010, p. 305.

<sup>560</sup> Hu, Chee Mee, “Moody’s Assigns a Prospective (P) A2 Rating to the Senior Unsecured Debt Obligations of the Panama Canal Authority in Conjunction with the Expansion Project. The (P) A2 Rating Pierces the Current Country Ceiling of A3 by One Rating Notch,” Moody’s Investors Service, September 10, 2008.

<sup>561</sup> Interview by author with Christopher C. McIsaac, Washington, D.C., September 16, 2014.

<sup>562</sup> Bigler 2015.

<sup>563</sup> The crown, a gift from Pope Sylvester II to the new king of Hungary in 1000, resided at Fort Knox for safekeeping beginning in World War Two, when the Hungarians, fearful of the Germans and Soviets,

capture the canal was as significant as the canal's original construction. The power of that idea has helped Panamanian civil society build ramparts around the canal. The canal's defenders say a president or lawmaker who meddles in canal business will have hell to pay. That canal profits are a vital budget ballast for Panama also motivates policymakers to tread carefully when addressing canal business. The impression that the canal mints money, and that it is virtually incorruptible, makes it easier to repel barbarians at the gates.

But if national pride, historical importance and dollars-and-cents are enough to safeguard a state-owned enterprise, then why has Venezuela immolated its national oil company, PDVSA? Why is Brazil's Petrobras, once a case study in state-owned enterprise management, now the poster boy for corruption? Why is Mexico's Pemex desperately searching for a private sector lifeline to reverse chronically declining reserves? After all, like the Panama Canal, these companies are essentially natural monopolies that face no local competition. Wouldn't rational choice theory predict that Panamanian elites, like their counterparts throughout the region, would scramble for canal spoils without regard for lofty notions such as national pride?

In the case of the Panama Canal, there are clearly other factors at play. As always, context matters. The Panama Canal Authority was born out of a crisis: the 1989 U.S. invasion of Panama. It was Panama's thoughtful response to that crisis that offers the most persuasive insight into the country's unexpected canal success: (1) Panamanian elites developed an enduring, deep and detailed consensus about the management of the canal; (2) two Panamanian presidents, of different political parties, and Panamanian

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loaned it to the United States. Carter sent a high-level delegation, led by Secretary of State Cyrus Vance, to Hungary to return the crown. The gesture attracted widespread criticism in the United States. The crown is now on display in Budapest, at the Hungarian National Museum.

lawmakers built upon that consensus to develop a robust constitutional and legislative framework for the Panama Canal Authority that guaranteed extraordinary autonomy, at least on paper; and (3) canal leaders and Panamanian civil society have jealously defended that framework ever since.

### **From ‘Just Cuz,’ a National Cause**

By any definition, the 1989 U.S. invasion of Panama, known as “Operation Just Cause,”<sup>564</sup> was a critical juncture for Panama’s modern political development. Noriega’s ouster could easily have unleashed a spasm of political violence, not to mention political paralysis. Torrijos and Noriega had tried to suffocate civil society. Government ministries were in ruins, their windows shattered and their archives raided.<sup>565</sup> The war prompted extensive looting.<sup>566</sup> The economy was reeling. Freed of Noriega’s repression, personal and political rivalries were free to resume. Today, Panamanians have above average trust in their neighbors,<sup>567</sup> but in the aftermath of the U.S. invasion, common crime increased and grudges and grievances ran deep. Crises, however, do not always bring chaos. Indeed, Kurt Weyland has observed that severe policy challenges, coupled with the arrival of new political leaders, are often a prerequisite for bold policy reforms. In these cases, fears of a deepening crisis motivate “drastic, daring” action.<sup>568</sup> In Panama, this appears to have occurred. Panamanian elites exhibited exceptional political learning from

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<sup>564</sup> Critics mocked the invasion as “Operation Just Cuz.”

<sup>565</sup> Rolando Castillo, Nicanor Perlas, Gerardo Noto, Max Hernández, Elena Díez Pinto and Miguel Ángel Balcárcel, *El Diálogo Democrático en Panamá: Bambito Diez Años Después* (New York City: United Nations Development Program, 2004), p. 12.

<sup>566</sup> Sánchez 2007, p. 174.

<sup>567</sup> In 2013, 19 percent of Panamanians had confidence in most people, above the regional average of 17 percent, according to the United Nations’s Economic Commission for Latin America and the Caribbean CEPALSTAT database.

<sup>568</sup> Kurt Weyland, *The Politics of Market Reform in Fragile Democracies: Argentina, Brazil, Peru and Venezuela* (Princeton, N.J.: Princeton University Press, 2004), p. 3.

their post-Torrijos traumas.<sup>569</sup> The U.S. invasion provoked howls of protest from Latin American leaders, who fetishize territorial sovereignty and anti-colonialism. On December 21, 1989, the Organization of American States held an emergency meeting on Panama, where regional representatives denounced the United States. In Panama, however, the population largely accepted their new president, Guillermo Endara (1989 to 1994), though he had been sworn-in at Howard Air Force Base after midnight as the U.S. invasion began, alongside his two vice presidents, Guillermo “Billy” Ford and Ricardo Arias Calderón. Instead, the protestors in Panama were concentrated in front of Apostolic Nunciature, where Noriega had sought asylum<sup>570</sup> on Christmas Eve, arriving hidden under a blanket in the back seat of a car, his military fatigues replaced by shorts, a t-shirt and a baseball cap.<sup>571</sup> Rapidly, feuds and finger pointing gave way to rebuilding institutions and damaged and neglected infrastructure. Panamanians decided they had hit rock bottom, and that alone helped stop the fall. “Panama was a defeated and humiliated country,” Cardoze, the former canal board member, said.<sup>572</sup>

Post-invasion Panama faced a dizzying array of challenges. But a consensus quickly emerged on the most pressing national priority: keep the Panama Canal from crumbling after the U.S. exit. Suddenly, and for the first time, Panama got serious about its preparations to take over the canal. Endara began attending Panama Canal

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<sup>569</sup> This political learning was not inevitable, as other democratic transitions have merely restored preexisting political pathologies. In Uruguay, for example, a contemporary complaint is that the 1984 election that ended the military dictatorship marked the return of unreformed Colorado and Blanco political parties. A common Uruguayan lament: Like the Bourbons in France, “they learned nothing and forgot nothing.”

<sup>570</sup> Noriega surrendered on January 3, 1990, after several days holed up in the Vatican’s embassy, subjected to David Bowie, Twisted Sister and “I Fought the Law” blasting from speakers the U.S. military had set up, and threatened by a crowd of angry Panamanian protestors surrounding the building. The U.S. military transferred Noriega by helicopter to Howard Air Force Base, where he was placed in the custody of the U.S. Drug Enforcement Administration.

<sup>571</sup> Fernando Berguido, “A Hidden Dictator: The Invasion of Panama,” *ReVista Harvard Review of Latin America*, Spring 2013.

<sup>572</sup> Porras 2007, p. 171.



Commission board meetings focused on the transition. On May 1, 1991, he established a nine-member commission, led by Joaquin J. Vallarino, one of Panama's richest men, to draft a formal canal transition plan.<sup>573</sup> The commission was multipartisan and included representatives of diverse professions.<sup>574</sup> It was that commission – buoyed by public disgust with Panama's political class – that in January 1994 introduced the most important element of Panama's future canal management strategy: an independent canal administration<sup>575</sup> with its mandate enshrined in the constitution. That concept endured throughout the final phase of the canal transition period, and it continues to serve as the bedrock of the Panama Canal Authority. The harmony should not be exaggerated. The Panama Canal Authority's founding fathers wrangled over the proposed constitutional amendment, originally drafting 40 potential articles. But they all agreed on the need for autonomy, without which “the canal would become a piñata.”<sup>576</sup> In addition to a general mistrust of government institutions, there was widespread uncertainty about Panama's technical capability to manage the canal. That skepticism further strengthened the Vallarino Commission's argument for radical independence. At the canal itself, workers were nervous, union leader Felipe Joseph recalled. “We did not trust our people,” he said. “We didn't have the word ‘maintenance’ in our culture.”<sup>577</sup> That sense of insecurity lent the post-Noriega canal transition efforts an urgency unseen in Panama since the 1977 treaty signings. “The Panamanians themselves have doubts,” Vallarino conceded in 1994,

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<sup>573</sup> Wilkinson, Tracy, “An Uneasy Passage in Panama: New Leader Assures the World that his Nation Will Be Ready to Take Over the Canal as Deadline Nears. But Many Residents See Stability and Profits Leaving with U.S. Troops,” *The Los Angeles Times*, June 6, 1994.

<sup>574</sup> Interview by author with Juan B. Sosa, August 28, 2014.

<sup>575</sup> Sánchez 2007, p. 178.

<sup>576</sup> Porras 2007, p. 59.

<sup>577</sup> Interview by author with Felipe Joseph, Panama City, Panama, August 22, 2013.

“they are frightened.”<sup>578</sup> Thanks to the commission’s leadership, Panama’s Legislative Assembly – on December 25, 1993 – gave initial approval to the constitutional amendment establishing the Panama Canal Authority. It was a tremendous feat for Panama’s newly democratic government. The commission, however, had not independently conjured up the canal administration’s unique structure, or the social consensus that provided its legitimacy and sustainability. Acting alone, the commission’s recommendations might never have been implemented, given the dramatic changes in the presidential palace and legislature that occurred in the middle of the canal policy debate. Today’s effective canal governance was not the product of any elite pact. Nor was it imposed by the United States, notwithstanding the valuable technical assistance and nudging from U.S. canal authorities. Rather, Panama’s canal success is best explained by the country’s exceptional, postwar effort to construct a social consensus regarding canal management.

### **Bambito**

The U.S. invasion rid Panama of Manuel Noriega, destroyed Noriega’s repressive armed forces and reintroduced democratic government. But it did nothing to diminish social and political polarization. As mentioned, those tensions threatened to convulse postwar Panama in 1990, raising basic questions about governability. Panamanians feared that the next presidential election, scheduled for May 1994, would provoke a repeat of the civil unrest that marred the May 7, 1989 vote, a democratic experiment that ended with Noriega’s security forces pummeling opposition candidates in the street, after electoral authorities deprived Endara of his victory. Following the U.S. invasion, Panama found

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<sup>578</sup> Ibid.

itself in a state of “decomposition, separation and antagonism,” as Stanley Mushett, president of the Universidad Interamericana de Panamá, put it.<sup>579</sup> Freed of Noriega, Panama was still “suffering every type of instability, political, legal, civil liberties,” Ford, Endara’s former vice president, recalled. “There was no mechanism for the warring parties to sit together respectfully in a dialogue designed to establish guidelines for bringing about a grand reunification of the Panamanian family.”<sup>580</sup> To prevent renewed violence, Panama’s Catholic church set up the Commission for Justice and Peace, calling together all political parties in pursuit of national reconciliation.<sup>581</sup> Every major party participated, including the Partido Revolucionario Democrático, the former civilian arm of the Noriega dictatorship. On May 18, 1993, on the campus of Santa María La Antigua University in Panama City, representatives of the political parties signed the Declaration of Santa María La Antigua. It committed all Panamanian political actors to support a transparent election in 1994; to strengthen Panama’s distrusted Electoral Tribunal; and to permit a peaceful transfer of power following the vote, regardless of the winner.<sup>582</sup> Signatories included two future presidents, Pérez Balladares and Mireya Moscoso (1999 to 2004).

The church dialogue – following a smaller effort led by women’s organizations in November 1992 that was later known as “Taboga I,” after the Pacific Ocean island where the 50 women leaders gathered – lowered tensions considerably. Following the church dialogue, Panamanian political representatives continued to meet every Monday to

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<sup>579</sup> Mario Solórzano Martínez, *Cuando los Políticos Cumplen: Experiencias del Proceso de Negociación Panamá 2000* (New York City, N.Y.: United Nations Development Program, 1997), p. 28.

<sup>580</sup> Castillo 2004, p. 14.

<sup>581</sup> *Análisis de las Experiencias Nacionales, Bambito I o Declaración de Santa María la Antigua* (New York City: United Nations Development Program).

<sup>582</sup> Castillo 2004, p. 13.

discuss the upcoming elections.<sup>583</sup> “The phenomenon of a political dialogue that would bring together all the parties was unheard of in Panama’s history.”<sup>584</sup> Nevertheless, Panamanians still regarded free, fair and peaceful elections in 1994 as a long shot. In stepped the United Nations. From August 2-3 of 1993, the United Nations Development Program’s Panama office brought together political and civil society leaders for further discussions – the first formal, multiparty dialogue in the country’s history.<sup>585</sup> “It pained me deeply,” said Victoria Figge, who represented the private sector at the United Nations dialogue, “to see how atomized Panama had become.”<sup>586</sup> In getting involved, the United Nations took its inspiration from the 1978 Moncloa Pact, a broad-based political agreement in Spain that had advanced that country’s post-Franco democratization.<sup>587</sup> This time, the agenda in Panama focused not only on the upcoming elections, but also sought consensus on public policy goals for the next government.<sup>588</sup> (The United Nations would later characterize the dialogue as seeking nothing less than the “re-founding” of Panama.<sup>589</sup>) Business leaders, labor activists, clergy and university administrators joined the dialogue. To avoid media scrutiny, the United Nations hosted the closed-door meetings at the Hotel Bambito, corralling Panamanian elites into a remote mountain hotel in Chiriquí province, six hours from Panama City, next to the Barú volcano. The gathering’s final declaration listed former Colombian President Belisario Betancur (1982 to 1986) and former Uruguayan President Julio María Sanguinetti (1985 to 1990, 1995 to 2000) as official witnesses and noted that the original, signed document would be

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<sup>583</sup> Solórzano Martínez 1997, p. 30.

<sup>584</sup> Orlando J. Pérez, *Political Culture in Panama: Democracy After Invasion* (New York City, N.Y.: Palgrave Macmillan, 2011), p. 123.

<sup>585</sup> Sánchez 2007, p. 189.

<sup>586</sup> Castillo 2004, p. 15.

<sup>587</sup> Ibid, p. 14.

<sup>588</sup> United Nations Development Program.

<sup>589</sup> Castillo 2004, p. 15.

archived at the United Nations. Signatories included, *inter alia*, a future president, Pérez Balladares, and senior Panamanian canal officials including Manfredo, the future interim canal administrator. The agreement had various audiences, designed in part to “offer Panamanians and the international community evidence that Panamanians had fully assumed their historic responsibilities.” Later known as “Bambito I,” the historic dialogue concluded with a broad agreement to:

- Strengthen Panamanian democracy;
- Design effective legal and administrative structures for running the Panama Canal;
- Promote economic and social development;
- Modernize educational and health services;
- Build consensus regarding the use of reverted land in the former Panama Canal Zone; and,
- Improve government efficiency and judicial independence.

Participants emerged with renewed confidence in Panama’s future. “One of the benefits is that we could not kill one another,” Roberto Brenes, who represented the Renovación Civilista Party at Bambito I, said.<sup>590</sup> The following year, a month before the May 1994 election, the United Nations convened Bambito II. This time around, organizers had a single objective: Persuade presidential candidates to endorse the Bambito I declaration. On April 4, 1994, five presidential candidates gathered<sup>591</sup> – including the eventual winner, Pérez Balladares, of the Partido Revolucionario Democrático – and signed the Bambito I declaration. Critically, the meeting helped

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<sup>590</sup> Castillo 2004, p. 16.

<sup>591</sup> The candidatos included Rubén Darío Carles (Alianza Cambio 94); Samuel Lewis Galindo (Concertación Nacional); José Salvador Muñoz (Partido Panameñista Doctrinario); Ernesto Pérez Balladares (Alianza Pueblo Unido); and Eduardo Vallarino (Partido Demócrata Cristiano).

preserve the hard-fought “political détente” in the run-up to the hard-fought presidential election.<sup>592</sup>

The election went smoothly.<sup>593</sup> In his final report, U.S. President Jimmy Carter, who observed the vote alongside a former Belizean prime minister and a former Costa Rican president, called the process an “extraordinary expression of civic participation.” Panamanians regarded the free, fair and transparent vote as a major step in the reestablishment of Panama’s democracy. But at first sight, the election results seemed to imperil the national reconciliation process and Endara’s efforts, led by the Vallarino Commission, to plan for the canal transfer. Pérez Balladares’s narrow victory had thrust into power a party closely tied to the odious Noriega dictatorship.<sup>594</sup> There was reason to fear not only for Panama’s democracy, but also the future of the proposed constitutional reforms regarding the future canal administration. As noted, the previous legislature had approved the canal constitutional amendment, but the reforms now needed a second vote by lawmakers. Without the new president’s backing, legislative success was doubtful. Concerned about the transition process, McMillan, the chairman of the U.S.-led Panama Canal Commission board, met with Pérez Balladares to urge his support for the proposed constitutional reform.<sup>595</sup>

From December 4-6, 1994, the United Nations once again called together Panamanian elites. The successful election and transfer of power to the political

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<sup>592</sup> Pérez 2011, p. 125.

<sup>593</sup> Pérez Balladares attracted 33 percent of the vote, followed by Mireya Moscoso of the Arnulfista Party, who earned 29 percent. The singer Ruben Blades came in third, with 17 percent. Panama’s legendary ambassador to the United States, Samuel Lewis Galindo, came away with 2 percent.

<sup>594</sup> Alfredo Castillero Calvo, ed., *Panamá, Historia contemporánea (1808-2013)* (Madrid, Spain: Taurus, 2014).

<sup>595</sup> McMillan 2009, p. 86.

opposition had greatly reduced tensions. The election winners, in office 100 days,<sup>596</sup> felt they had a mandate to pursue their platform without externally imposed compromises or obligatory consultations. Still, United Nations organizers hoped a post-election conference would institutionalize Panama's new dialogue process. Pérez Balladares reluctantly agreed to address the Bambito III meeting. In his remarks, he expressed skepticism about the continued need for a dialogue mechanism. But he mentioned the canal among the "major issues on which consensus is needed."<sup>597</sup> Reassuringly, he spoke of the symbolic value of having a constitutional amendment regarding the canal approved by two politically diverse congresses. For the purposes of the United Nations dialogue, however, consensus eluded the group. No party leaders signed on to the United Nations pledge to make the dialogue a permanent feature of Panamanian public life.<sup>598</sup>

Nevertheless, on canal matters, Pérez Balladares kept his promise to prioritize canal planning and avoid a partisan or unilateral approach. On January 25, 1995, he set up his own canal Transition Commission, filling the role of Endara's Vallarino Commission. He also formally endorsed Endara's constitutional amendment, and lawmakers gave it a second and final approval on May 26, 1995. "The approval of the constitutional amendment by two congresses whose compositions were diametrically opposed, and accepted by two presidents from rival parties, demonstrates the existence of the will and determination to put the nation's interest ahead of electoral rivalries."<sup>599</sup>

The United Nations acknowledged the failure of Bambito III. For a time, it appeared that Panama had moved on. There remained at least one issue, however, that

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<sup>596</sup> Pérez Balladares was sworn-in on September 1, 1994.

<sup>597</sup> Castillo 2004, p. 21.

<sup>598</sup> United Nations Development Program.

<sup>599</sup> Ibid.

called out for collective action: Pérez Balladares's preparations for running the Panama Canal. So despite the onset of political normalcy, on May 8, 1996, the United Nations, aided by the Carter Center, again convoked Panama's leading political and civil society actors, this time at the Hotel Coronado. Moscoso, the former candidate and future president, declined to participate.<sup>600</sup> In general, however, the "Encuentros Panamá 2000" dialogues – also known as Coronado I, II, III and IV – found participants in an agreeable mood. Endara had taken steps to insulate the canal from party politics and enshrine its autonomy in Panama's constitution.<sup>601</sup> His political rivals and successors embraced that effort. In fact, everyone involved in the United Nations dialogues shared the goal of establishing an effective canal administration that would inspire confidence in canal customers and throughout the international community.<sup>602</sup>

The United Nations had set up a support group to legitimize the new dialogue, and it oversaw three months of discussions on a proposed agenda.<sup>603</sup> Representatives from political parties, labor organizations, women's and indigenous groups, religious sects and others entered into a solemn pact to protect the canal from Panama's dysfunctional domestic politics. Ramón Morales Quijana of the Molirena Party (Nationalist Republican Liberal Movement) delivered the plenary address at the opening of the Coronado dialogues, arguing that the two essential ingredients of a successful canal were "democratic stability" and "the ability to reach, and comply with, a national agreement that prevents the politicization of the Panama Canal."<sup>604</sup> The Coronado dialogues, he said, should work toward the "separation of the canal, its operation and

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<sup>600</sup> Her party subsequently joined the Coronado dialogue process, according to United Nations records.

<sup>601</sup> Castillo 2004, p. 12.

<sup>602</sup> Ibid.

<sup>603</sup> Solórzano Martínez 1997, p. 53.

<sup>604</sup> Ibid., p. 55.



administration from partisan quarrels.”<sup>605</sup> Representing Panamanian civil society, Mariela Arce argued for transparency, saying “the canal is for all Panamanians, too vital to be run outside the view of the general population.”<sup>606</sup>

Pérez Balladares’s continued enthusiasm bolstered the Coronado dialogues. The president assigned trusted advisers to participate, including Foreign Minister Ricardo Arias; Labor Minister Mitchell Doens; and Adolfo Ahumado, a member of the new president’s canal Transition Commission.<sup>607</sup> Pérez Balladares personally joined the discussion, and his “presence left little doubt about the importance that the government placed in the event.”<sup>608</sup> In his remarks, Pérez Balladares said Panama had only 1,315 days left to prepare to receive the canal; emphasized the next steps to advance the proposed constitutional reform; highlighted the legislative efforts to design the Panama Canal Authority; and pledged to submit the draft legislation to all political parties and civil society organizations for their input.<sup>609</sup> He told the gathering:

“However abysmal are our distances in other areas, I will always be willing to freeze those debates to sit together and discuss the future of the canal.... The canal does not belong to any political party, and its success is vital for all. No Panamanian, much less those who hope to have an important influence on the future of the country, has the right to isolate himself from the canal issue.”<sup>610</sup>

To prove that the canal would not be a partisan prize, Pérez Balladares appointed Aléman, the respected engineer who had led the Blue Ribbon Engineering Committee, to serve as the Panama Canal administrator starting in 1996.<sup>611</sup> In contrast to his response to the Bambito III gathering, Pérez Balladares publicly celebrated the Coronado dialogue as

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<sup>605</sup> Ibid., p. 73.

<sup>606</sup> Ibid., p. 71.

<sup>607</sup> Ibid., p. 74.

<sup>608</sup> Ibid., p. 75.

<sup>609</sup> Ibid.

<sup>610</sup> Ibid., p. 76.

<sup>611</sup> Alemán was sworn-in as the canal administrator on August 18, 1996.

a “milestone of transcendental importance.”<sup>612</sup> His vice president, Ricardo Arias Calderón, published an op-ed lauding Panama’s “national spirit” to master canal administration and oversee an inclusive transition process.<sup>613</sup> Pérez Balladares committed to continued participation in the United Nations Coronado dialogues, and he made sure his advisers did the same. When Coronado dialogue participants split into working groups, it was Jorge Ritter, chairman of Pérez Balladares’s canal Transition Commission,<sup>614</sup> who lectured an audience of 23 about the Transition Commission’s progress.<sup>615</sup> (Alemán addressed a second working group, in which 19 participants discussed the future of the canal. Morales, the opposition leader, led the third working group, leading 21 participants in a conversation about governability and Panama’s 1999 presidential elections.) By the end of the sessions, the Coronado I participants committed to:

1. Exclude party politics from the Panama Canal Authority;
2. Guarantee merit-based hiring for canal jobs;
3. Advance public discussions regarding legislation governing canal operations; and,
4. Provide a joint declaration to the Organization of American States secretary general at the Organization of American States General Assembly in Panama June 5-7, 1996.

After the Coronado participants signed the final declaration, everyone stood to sing Panama’s national anthem, many in tears.<sup>616</sup> The newspaper *La Estrella de Panamá*, in a May 30, 1996 editorial, praised the Coronado process, calling “the return of the canal the common denominator” for all Panamanians. The communal canal planning, the

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<sup>612</sup> Solórzano Martínez 1997, p. 83.

<sup>613</sup> Ibid., p. 84.

<sup>614</sup> Pérez Balladares staffed the canal Transition Commission with the four Panamanian members of the U.S.-led Panama Canal Commission board, among others.

<sup>615</sup> Solórzano Martínez 1997, p. 78.

<sup>616</sup> Ibid, p. 84.

newspaper wrote, “managed to dispel suspicions, distrust and doubts that have so often impeded and even shut down communication channels between diverse political factions.”<sup>617</sup>

The United Nations dialogues continued August 25-27, 1996 (Coronado II), this time dedicated to detailed discussions of the proposed canal legislation. Four workshops addressed the draft canal law: one on administration, organization and finances; a second on operational issues, including tolls; a third on environmental protection in the canal watershed; and a fourth on labor relations at the canal.<sup>618</sup> From September 22-24, 1996 (Coronado III), the United Nations discussions moved on to the future uses of the vast real estate in the former Panama Canal Zone that was gradually falling into Panama’s hands. Through all these lengthy philosophical conversations and technical debates, Panamanian elites “overcame the anguish of the past and trauma from an immense assault on its sovereignty”<sup>619</sup> and demonstrated a political maturity the country lacked for decades, if not its entire history, and that most countries never achieve. For certain, the relatively small size of Panama’s elite, and the racial and religious homogeneity of its elite,<sup>620</sup> helped bring about agreement on canal issues. Still, the accomplishment was remarkable, particularly in Latin America, a region where political and social consensus is rare and distrust is an inescapable cultural attribute. In a demonstration of the profound impact of the United Nations dialogues, Panamanian lawmakers on May 14, 1997 passed the canal’s basic law. On June 11, 1997, Pérez Balladares signed it into law. Remarkably, neither that legislation nor the canal’s constitutional amendment have been touched since

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<sup>617</sup> Ibid., p. 85.

<sup>618</sup> Ibid., p. 92.

<sup>619</sup> Ibid., p. 19.

<sup>620</sup> Panama’s broader population is relatively diverse: 65 percent mestizo, 12 percent indigenous, 9 percent black, 8 percent mulatto and 7 percent white. The country is 85 percent Catholic and 15 percent Protestant.

their passage. The closest Panama has come to tweaking either foundational document was near the end of Alemán's tenure as canal administrator, when his supporters clamored for a relaxation of term limits. He resisted, in a sort of George Washington gesture. "We're just passengers," he said. The canal needs a "strong system."<sup>621</sup> Others have followed Alemán's lead. "Credible accusations of corruption, politicizing or even failing to invest sufficiently in the Panama Canal became an electoral kiss of death."<sup>622</sup>

The United Nations Development Program takes great pride in its contribution to Panama's preparations for assuming its canal duties. It has repeatedly analyzed and memorialized the Bambito and Coronado dialogues. Sadly, in contemporary Panama, the dialogues are mostly forgotten, according to Harry Brown, a governability specialist for the United Nations Development Program's Panama program and its unofficial historian. However, those who participated in the canal transition process give tremendous credit to the dialogues. More than national pride in the canal; or an appreciation of its monetary value ("golden goose"); or the fear of losing its budget support ("too-big-too-fail"); or admiration for its performance ("if-it-ain't-broke-don't-fix-it"), it was these dialogues that brought about the Panama Canal's winning legal and administrative structure and created an atmosphere in which Panama could realize its dream of an independent, nonpartisan, moneymaking canal. "The political class had the maturity to act correctly," Cardoze, the former canal board member, said.<sup>623</sup> "It was a triumph for all Panamanians."

For that reason, it is difficult, and ultimately misleading, to identify the intellectual authors of the canal reforms. The pursuit of the origins of the canal's governing philosophies is an interesting academic challenge. These critical ideas are

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<sup>621</sup> Interview by author with Francisco Loaiza, Panama City, Panama, August 13, 2013.

<sup>622</sup> Mauer 2010, p. 329.

<sup>623</sup> Porras 2007, p. 177.

variously traceable to U.S. canal officials, Panamanian thinkers and foreign state-owned enterprises that inspired Panama's early canal leadership. Ultimately, however, Panama's canal "has no father," as Aléman put it. "It was the entire Panamanian society."<sup>624</sup> I. Roberto Eisenmann Jr., who returned from political exile during Torrijos's rule to establish the influential newspaper *La Prensa*, also credits a virtually simultaneous, countrywide agreement on the canal's future. "Panamanians formed a national consensus that telegraphed to all politicians: 'Don't fuck around with our canal.' That's basically what it is. That was something felt throughout the society," Eisenmann said.<sup>625</sup> "Suddenly, the enemy disappeared. Suddenly, we couldn't blame anyone for our failures," he said. "It's very easy to blame the gringos for everything wrong with the country, but suddenly, the gringos were gone."

On July 7, 1997, Ritter, who had led Pérez Balladares's canal Transition Commission, became Panama's first minister of canal affairs. On December 27, 1997, Panama formally established the Panama Canal Authority (to succeed the U.S.-led Panama Canal Commission following the canal turnover) and set up its governing board. It was still two years before Panama would actually supervise the waterway, but the Panamanian board began holding meetings on February 12, 1998. On July 17, 1998, it started organizing joint sessions with the binational board of the U.S.-led Panama Canal

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<sup>624</sup> Not surprisingly, there are competing claims to authorship of the Panama Canal Authority's governing structure. Cardoze, for example, told the author that he floated the idea for an autonomous canal authority in a pamphlet he published in 1990. His ideas reflected lessons from the U.S. checks and balances system, and cautionary tales in Panama, where supposedly autonomous state entities – such as the former Instituto de Recursos Hidráulicos y Electrificación, the Caja de Seguro Social and the Lotería Nacional de Beneficencia – failed to attain true operational independence. "There always has to be an architect," he said. Lewis, the former vice president and foreign minister, also argued that the intellectual underpinnings of the Panama Canal Authority predate the United Nations Bambito and Coronado dialogues. Omar Jaén Suárez, in his official history of the canal under Panamanian control, offered several potential origins for central elements of the Panama Canal Authority structure, including the remarks by Ecuador's ambassador to Panama during the Universal Congress on the Panama Canal, September 7-10, 1997.

<sup>625</sup> Interview by author with I. Roberto Eisenmann Jr., Panama City, Panama, August 22, 2013.

Commission. By the end of the canal transition process, Panama was no longer cramming for an exam the night before. It had reached a national consensus on canal governance, institutionalized the transition process and built the constitutional and legislative architecture for its future canal administration. To symbolize the seriousness and urgency of its preparations, Panama erected a giant digital billboard that counted down the hours, minutes and seconds until the December 31, 1999 canal turnover.

### **Hands Off the Canal**

The result of the post-war United Nations dialogues in Panama is a state-owned enterprise with a highly unusual degree of independence, both on paper and in practice. The Panama Canal Authority's constitutional charter describes it as an autonomous legal entity with exclusive authority to operate the canal and manage its finances.<sup>626</sup> It is free of most taxes. It is also largely free of Panama's powerful president; the constitution gives the president the power to appoint unilaterally only one member of the Panama Canal Authority's 11-member Board of Directors,<sup>627</sup> with legislative approval required for the president's nine other board appointees.<sup>628</sup> (Panama's unicameral legislature unilaterally appoints the eleventh board member.) Board members serve staggered, nine-year terms, with three members up for replacement every three years. That limits the influence of any particular president, given Panama's prohibition on reelection following a single, five-year term. For Vallarino, who led the original canal transition commission under Endara, these clever leadership guidelines are almost beside the point. Panama Canal Authority board members, he said, "forget who named them as soon as they arrive, where they

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<sup>626</sup> Chapter 14, Article 316, <http://www.acp.gob.pa/eng/legal/title/index.html>.

<sup>627</sup> The direct presidential appointee is the country's canal minister, but the minister rarely attends cabinet meetings.

<sup>628</sup> Chapter, 14, Article 318, <http://www.acp.gob.pa/eng/legal/title/index.html>.

came from and their political party, and begin to work for the canal.”<sup>629</sup> That’s important, considering the powers of the Board of Directors. The board is invested with quasi-legislative authority, and the right to set tolls and fees. In addition, the constitution grants the canal administration a special, merit-based labor regime that guarantees workers, at minimum, the preservation of the perquisites and prerogatives they enjoyed under U.S. control.<sup>630</sup> The canal’s special labor regime even bans strikes, a controversial element in a country and region notorious for labor activism. Critically, the canal has complete financial independence, insulating it from “the back and forth of the political winds.”<sup>631</sup> Its budget is subject to legislative approval, but only by an up-or-down vote that by tradition is always up. Consequently, Panamanian lawmakers “have no whip to punish the authority,”<sup>632</sup> Barletta, the former president, said.

To preserve this operational independence, the canal generates its own electricity, pumps its own drinking water and bans its employees from seeking political office.<sup>633</sup> Its leadership is aware that the Panama Canal Authority’s freedoms are not only uncommon globally, but also within Panama itself. “They gave the canal authority an autonomy that no other institution has,” Benítez, the deputy canal administrator, said.<sup>634</sup> Outsiders agree. “If there is anything that Panamanians got right,” said Uccelli, of J.P. Morgan, it was how they “structured management so no government could use this as a cash cow, as the current regime in Venezuela does with oil.”<sup>635</sup> Klein, the Johns Hopkins professor, compares the Panama Canal Authority to the charter city model, a radical experiment

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<sup>629</sup> Suárez 2010, p. 218.

<sup>630</sup> Chapter, 14, Article 322, <http://www.acp.gob.pa/eng/legal/title/index.html>.

<sup>631</sup> McIsaac 2014.

<sup>632</sup> Barletta August 27, 2013.

<sup>633</sup> Maurer 2010, p. 303.

<sup>634</sup> Benítez August 5, 2013.

<sup>635</sup> Uccelli 2014.

through which a government promotes economic development by establishing an independent city state within its borders, subject to its own or foreign law and free to control immigration and other core public policies. Though the Panama Canal Authority remains a public entity, Klein said, its structure resembles a concession to a non-profit infrastructure operator. It is this robust structure – coupled with a vigilant civil society that emerged from the United Nations dialogues – that best explains the canal’s apparent incorruptibility.

### **Show Me The Money**

The Panama Canal’s administrative structures are impressive. But any formalistic explanation for the canal’s performance – in other words, an excessive focus on its legal character – tells only part of the story. The extraordinary political learning expressed in the United Nations Bambito and Coronado dialogues gave the canal the breathing room it needed to set up its governance model. However, its long-term success also required dramatic cultural transformations at the canal administration. Here, as in most cases, leadership played a major role. Under the United States, the canal had operated as a break-even, hierarchal enterprise, with a quasi-religious dedication to low tolls.<sup>636</sup> Panamanians whose careers spanned the canal transfer recalled a “a cult of rank and an aversion to change.”<sup>637</sup> Firings were unheard of. The payroll was bloated. Engineers were far more common than business school graduates.

In a single sentence, the constitutional amendment establishing the Panama Canal Authority – Title 13 – demanded a radical rethinking of the canal’s role: “An autonomous

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<sup>636</sup> Since U.S. ships were the primary canal customers, the low tolls essentially subsidized U.S. exporters and importers.

<sup>637</sup> Morgan 2015, p. 92.



legal entity by the name of Panama Canal Authority is hereby established under public law, which shall be exclusively in charge of the administration, operation, conservation, maintenance and modernization of the Panama Canal and its related activities, pursuant to current constitutional and legal provisions in force, in order that it may operate the canal in a manner that is safe, continuous, efficient *and profitable*” (emphasis added).<sup>638</sup>

The canal’s basic law – No. 19, passed June 11, 1997 – reiterated the canal’s new moneymaking character. The purpose of this law “is to furnish the Panama Canal Authority with legislation for its organization, operation and modernization to make the canal a safe *and profitable* enterprise, a pillar in the human, social and economic development of the country” (emphasis added), Panamanian lawmakers noted in the preamble.<sup>639</sup> In Article 4, lawmakers again hit upon this theme: “The authority shall have the exclusive charge of the operation, administration, management, preservation, maintenance, improvement and modernization of the canal, as well as its activities and related services, pursuant to legal and constitutional regulations in force, so that the canal may operate in a safe, uninterrupted, efficient *and profitable* manner” (emphasis added). The canal law cannot be superseded by another law, only directly amended. (As mentioned, it also authorizes the canal board, rather than the legislature, to set additional canal regulations.)

Opting for an independent, for-profit business – rather than a traditional state-owned enterprise that serves as a blunt instrument of industrial policy, charged with creating jobs, reducing inflation and subsidizing other state-owned enterprises – was hard

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<sup>638</sup> Political Constitution of the Republic of Panama, Title 13, Article 316, <http://www.acp.gob.pa/eng/legal/title/index.html>.

<sup>639</sup> Organic law, Panama Canal Authority, Panama Legislative Assembly, Law No. 19, of June 11, 1997, “Whereby the Panama Canal Authority is Organized,” <http://www.acp.gob.pa/eng/legal/law/preamble.html>.

enough. Executing that transformation was an even greater challenge. Here, too, the Panamanians were not starting from scratch. As mentioned, the U.S.-led Panama Canal Commission had made preliminary efforts to ease the transition to a for-profit business model. Before the turnover, for example, the Panama Canal Commission established an economic research and market planning division.<sup>640</sup> Late in the U.S. canal era, Panamanian canal officials began studying other models, learning from the successes and failures of the Tennessee Valley Authority, the Suez Canal, Pemex and other state-owned enterprises. Still, the cultural changes, inside and outside the Panama Canal Authority, were “of immense magnitude,” according to Vásquez, the canal’s first Panamanian chief financial officer.<sup>641</sup> Prior to the canal turnover, U.S. employees resisted the reforms Aléman was implementing in anticipation of the coming Panamanian management. “They did not embrace change,” he said, “they wanted everything to stay the same.”<sup>642</sup> Outside the canal operations, Panamanians doubted the future Panama Canal Authority would maintain the professionalism of the U.S. personnel system. Canal jobs are attractive, so the pressure would be significant. In 2002 alone, the authority logged 67,568 job applicants.<sup>643</sup> After the U.S. exit, politically connected job seekers deluged Aléman. In response, he would send a form letter – to “legislators, presidents, ministers, everyone” – coldly detailing the canal’s merit-based hiring process. “There was no difference between the person who approached me on the street and the president of the republic,” he said.<sup>644</sup> (In his office in the historic Administration Building, Aléman lacked the authority to hire his own secretary or driver.) “There is no political pressure

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<sup>640</sup> Wainio, September 2, 2014.

<sup>641</sup> Porras 2007, p. 131.

<sup>642</sup> Interview by author with Alberto Alemán, Panama City, Panama, August 28, 2013.

<sup>643</sup> Suárez 2010, p. 90.

<sup>644</sup> Ibid.

for appointments,” Aléman said, despite a comically large waiting list. Jobseekers who asked Lewis, the former vice president and foreign minister, for a leg up also came up empty-handed. “I’d say, ‘I’ll do you a big favor. I won’t call, because that would *hurt* your chances.’”<sup>645</sup> Benítez, the canal’s deputy administrator, is also proud of the personnel system. “I don’t have a child working here,” he boasted.<sup>646647</sup> Similarly, the Panama Canal Authority takes great pride in its procurement system. Benítez calls it “a pillar” of the waterway. For Sánchez, the head of the canal’s purchasing division, it is a model operation. For example, the authority pays contractors within 30 days or it begins charging *itself* interest. That means “no one has to come bribe anyone to get their check,” eliminating a common source of corruption.<sup>648</sup> “We have a no tolerance policy for any type of corruption. Zero. If you step out of line and you’re caught, you’re going to get hit with a hammer,” Sánchez said.

As discussed, the Panama Canal Authority’s personnel and procurement policies were largely holdovers from the U.S. era, though their adaptation to Panama’s legal system and their dogged preservation are monumental achievements. Meanwhile, Panama’s reforms to the U.S. canal operation have been multitudinous, big and small, practical and symbolic. Alemán discontinued the free lawn mowing of canal residences, encouraged risk-taking and diminished the hierarchical, bureaucratic culture of a onetime U.S. military operation.<sup>649</sup> Early in his tenure, he sought out the opinions of canal

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<sup>645</sup> Lewis 2013.

<sup>646</sup> Benítez August 5, 2013.

<sup>647</sup> Domínguez, the inspector general, told the author that the canal struggles to avoid the appearance of nepotism, given that it has 10,000 employees in a country with only 3 million people and only a small percentage of the population is educated enough to handle canal leadership positions. For that reason, Domínguez makes a special effort to make sure no one has a no-show job, and enforces rules prohibiting relatives from supervising one another.

<sup>648</sup> Interview by author with Enrique E. Sánchez, Panama City, Panama, August 5, 2013.

<sup>649</sup> Eisenmann 2013.

employees of all ranks; at one point, he visited cable handlers at 3 a.m. After learning that low wage canal workers received toilet paper as part of their compensation because some shipowners failed to provide it, he chided union leaders and threatened to charge shipowners \$10,000 a roll for toilet paper the Panama Canal Authority provided to its workers who served aboard transiting vessels. To emphasize the canal's new business approach, he insisted that on the first day of the canal's revised reservation system, ships arriving on time for their reserved crossings be granted expedited access, even though a recently sunken tugboat had caused massive delays.<sup>650</sup> A reservation permits ships to avoid the unpredictability of the first-come-first-served system that leaves some ships waylaid for days on end waiting to cross. Today, vessels reserve a slot up to a year in advance, a popular option for cruise ships, car transporters and container ships. The system is also popular with the canal's bean counters. On August 24, 2006, for example, one ship paid \$220,300 to reserve its transit time and skip a 90-ship line and a weeklong delay.<sup>651</sup>

Alemán also instituted an array of new training programs that touched every part of the canal's vast workforce, compensating for the lack of comparable professional experiences in a country with little other heavy industry.<sup>652</sup> On average, canal employees are more educated today than at any time in the canal's history.<sup>653</sup> From 2000 to 2009, the percentage of canal employees lacking a high school diploma fell by 39 percent, and the percentage of canal employees with a postgraduate degree tripled.<sup>654</sup> As part of his

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<sup>650</sup> The reservation system, a major source of revenue, permits ship owners to pick a transit time slot up to one year in advance, or 18 months in advance for a passenger ship.

<sup>651</sup> Suárez 2010, p. 165.

<sup>652</sup> Speech by Gilberto Guardia Fábrega, July 26, 1995, Panama City, Panama.

<sup>653</sup> Suárez 2010, p. 86.

<sup>654</sup> Ibid., p. 116.

“management revolution,”<sup>655</sup> Alemán demanded his managers identify quantifiable goals and objective measuring tools,<sup>656</sup> an obsession that has outlived his tenure. Importantly, he not only raised tolls – repeatedly and significantly – but he made the canal a price discriminator starting in 2002. Under the United States, the amount of cargo determined the toll. (In 1928, for example, a swimmer paid just \$0.36 to cross the isthmus.) Panama, by contrast, began charging different tolls for different types of ships, and started billing for all support services, such as for the trains that pull ships through the locks and even for each cable that attaches the train to the ship. The result: the Panama Canal has become one of the most profitable transportation operations on earth.<sup>657</sup>

Alemán’s confidence inspired Panama Canal Authority officials. He “shattered the myth that we were incompetent,”<sup>658</sup> said Rogelio Gordón, who runs the dredging division in Gamboa from an office overlooking the canal, where giant iguanas sunbathe on shore and giant container ships lumber by. Alemán’s demanding leadership style helped, too. In the dredging division, despite 900 workers and a storied history, managers must constantly compete against the prospect of outsourcing. As a result, the division focuses relentlessly on its costs, speed and the condition of its machinery. Managers assemble every Friday to go over the metrics and scrutinize “dug time” (when equipment is out of service). Dredging is a costly and high-stakes function. Following a 1986 landslide in the Culebra Cut, the canal established an international advisory board of geologists to provide guidance, and it has installed sensitive monitors to detect potential landslides. The division operates the Titan floating crane, which can lift 350

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<sup>655</sup> Maurer 2010, p. 311.

<sup>656</sup> Suárez 2010, p. 43.

<sup>657</sup> Ibid., p. 312.

<sup>658</sup> Interview by author with Rogelio Gordón, Panama City, Panama, August 29, 2013.

tons and is used to move the lock doors for maintenance; the Goliath crane, with a capacity of 100 tons; and a \$50 million backhoe dredge, purchased in 2013 and given the name “Alemán.” Under Alemán’s leadership, the operations division became similarly data-driven. Its managers meet Wednesdays at 7:15 a.m. to evaluate their recent performance. There are consequences for employees too. The pilots contract, for example, provides bonuses for on-time performance.

Many Panamanian institutions trumpet accountability, but the canal authority has actually invested deeply in its anti-corruption efforts. The canal’s inspector general, Antonio Domínguez, supervises 55 employees and a \$3.5 million budget. To monitor the canal expansion, the Panama Canal Authority established a special anti-corruption office, opened 18 months before it solicited the first bids for the expansion and populated by 13 employees who are advised by the consultancies Talson Solutions and Hill International. The inspector general’s office is independent of the canal administration, and the inspector general himself is appointed by the canal board, not by the canal administrator. “Here, no one is safe,” Domínguez said. “If there is any doubt, I investigate.”<sup>659</sup>

This all-business approach is supported by the countless U.S. consultancies the Panama Canal Authority hires for market analysis and planning, and through close contact with the international maritime industry.<sup>660</sup> An international advisory board also helps maintain the canal’s high standards and independence. For all the talk of recovering its sovereignty, Panama prudently retained a direct role for foreign experts. Article 19 of the canal’s basic law established an advisory board to be appointed by the canal’s Board

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<sup>659</sup> Interview by author with Antonio Domínguez, Panama City, Panama, August 21, 2013.

<sup>660</sup> Alemán Spring 2013.

of Directors.<sup>661</sup> The law provided few details about the advisory board's role, and it is mandated to meet just once a year. In practice, the advisory board has turned out to be active and influential since the outside advisers first convened on December 13, 1999. The members are scholars and recognized experts in transportation, trade, business, telecommunications, construction and banking. Their meetings are held in London, Miami, Copenhagen, Santiago and Shanghai, and their advice is sought and considered by the canal's Board of Directors. The advisory board chairman, since 1999, is William A. O'Neil, the former secretary general of the International Maritime Organization. Other members include retired Admiral William J. Flanagan, the former commander of the U.S. Atlantic Fleet; Ernst Frankel, a professor at MIT; and Joseph Reeder, the popular former chairman of the U.S.-led Panama Canal Commission board, whose presence provides, symbolizes and broadcasts both the continuity and change that have been so central to the Panama Canal's recent success.

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<sup>661</sup> Here is Article 19, in its entirety: "Because of the international public service provided by the canal, the authority will have an advisory board on which Panamanian and foreign citizens may serve. The board of directors will designate the individuals who will make up this advisory board, taking into account their past experience and areas of expertise."

## **Chapter 5: Off the mark: Examining the historical context, conditions and biases that led to universal misjudgment of the Panama Canal's future**

### **Introduction**

How did everyone get everything so wrong? For as long as the U.S. government contemplated a canal turnover, critics forecast an aquatic apocalypse. Dire predictions coming out of the Panama Canal Zone and the U.S. Congress changed little over the decades of debate. As late as 1998 – two years before the turnover – the conservative American Enterprise Institute published a 168-page book questioning whether Panama could handle independence, let alone the canal.<sup>662</sup> There were bold warnings from boldfaced names like Ronald Reagan, Bob Dole, Jesse Helms and Strom Thurmond. The unknown tried to get known by their opposition, among them the U.S. lawmakers Dennis DeConcini, Philip Crane and John M. Murphy. For legions of naysayers, handing the canal to Panama was as good as dynamiting it. Panamanian neglect would let canal infrastructure crumble. Panamanian attention would invite patronage and corruption. Communists would infiltrate. Tolls would skyrocket. Terrorists would sabotage.

None of this occurred, of course, except perhaps the toll increases. That does not mean, however, that the critics were wrongheaded or biased, ignorant or imperialists. At least not all of them. On the one hand, by the late 1990s, it was far-fetched to expect canal operations to go completely off track after the U.S. exit. The transition to Panamanian control, as discussed, had churned out a skilled Panamanian workforce. Panama had stood up the Panama Canal Authority, with its independence constitutionally enshrined and fleshed out in legislation. The United States, egged on by Panama, had

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<sup>662</sup> Mark Falcoff, *Panama's Canal: What Happens When the United States Gives a Small Country What it Wants?* (Washington, D.C.: AEI Press, 1998).



poured tens of millions of dollars to upgrade the canal. On the other hand, Panama's history, both before and after independence, understandably fueled skepticism. After all, state-owned enterprises had struggled in far larger and richer nations, and Panama's record showed little evidence that it could sustain a complicated, multibillion dollar business.

### **Mettle or Meddled?**

Before Panama stood up to the United States over the Panama Canal, the ministate had largely accepted foreign political and economic influences; external factors, both positive and negative, seem to act upon the isthmus as naturally, and inevitably, as earthquakes.<sup>663</sup> A Spanish conquistador, Vasco Núñez de Balboa,<sup>664</sup> discovered Panama in 1513. Subsequently, Panama's economic fortunes were based largely on Spanish trade patterns. The Panamanian economy thrived while Spanish goods, toled by mules, passed through Panama to South America's west coast, while New World minerals, like Peruvian silver,<sup>665</sup> passed through Panama headed across the Atlantic to Spain. As global trade thrived, boomtown Panama imported 1,000 mules annually to make the four-day journey from sea to sea.<sup>666</sup> Beginning in the 1700s, however, several largely external factors left Panama's economy sputtering: (1) Panama's overland shortcut faced increasing competition, as shippers began plying the sea route around Cape Horn, at the southern tip of South America; (2) Spain struggled to defend its overseas territories (such

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<sup>663</sup> This account of early Panamanian history is based in large part on the Panama section of The Cambridge History of Latin America (Conniff, Michael. *The Cambridge History of Latin America*, Vol. 7, s.v. "Latin America Since 1930: Mexico, Central America and the Caribbean." Cambridge, United Kingdom: Cambridge University Press, 1990.

<sup>664</sup> Vasco Núñez de Balboa left Spain in 1500, failed to prosper as a farmer on the island of Hispaniola and then, fleeing creditors, settled in Panama, where he would eventually serve as the Spanish governor.

<sup>665</sup> Noel Maurer and Carlos Yu, *The Big Ditch: How America Took, Built, Ran and Ultimately Gave Away the Panama Canal* (Princeton, N.J.: Princeton University Press, 2010), p. 13.

<sup>666</sup> Ibid., p. 26.

as in 1667, when the Welsh buccaneer Henry Morgan, backed by England, stormed Portobelo, Panama's fortified Caribbean stronghold, and four years later, in 1671, led a 36-ship armada and 2,000 freebooters in the capture of Panama City, on the Pacific coast, which he looted and burned to the ground); (3) Panama's poor infrastructure and expensive mules hurt its competitiveness; and, (4) Peru's gold production gradually declined. Before long, Panama had devolved into a fledgling, abandoned colonial outpost.<sup>667</sup> Even so, Panamanians were reluctant to join the independence movement materializing in the region. It was not until November 28, 1821 that Panama seceded from Spain. Even then, Panama did not emerge as an independent state. Rather, Panamanians joined Simón Bolívar's Gran Colombia (1819 to 1830), comprising Panama, Colombia, Ecuador and Venezuela.<sup>668</sup> Upon Gran Colombia's dissolution, in 1830, Panama ended up a Colombian province, not a sovereign state.

Panamanians chafe at their portrayal as perennial pawns of outside powers, near and far. Indeed, following Bolívar's failed Gran Colombia experiment, Panama repeatedly sought to separate from Bogota during the nineteenth century. On its own, however, the province was no match for the Colombian forces. Nor was Colombia the only distant power influencing Panamanian affairs; in the era of Colombian control, Colombian authorities regularly asked the United States to protect their Panamanian province from foreign intervention while the Colombian government in Bogota focused on internal conflicts. Once Spain was out of the picture, the United States debated

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<sup>667</sup> Thomas M. Leonard, *Panama, the Canal and the United States: A Guide to Issues and References* (Claremont, Calif.: Regina Books, 1993), p. 8.

<sup>668</sup> In his well-known letter from Jamaica (September 6, 1815), Bolívar spoke hopefully about Panama's future role in the hemisphere: "How beautiful it would be if the isthmus of Panama could be for us what the isthmus of Corinth was for the Greeks! Would to God that some day we may have the good fortune to convene there an august assembly of representatives of republics, kingdoms and empires to deliberate upon the high interests of peace and war with the nations of the other three-quarters of the globe."

Panama's future internally and with British authorities, with no interest in the opinions of Panamanians and the occasional consultations with Colombia resulting in extraordinary concessions. On June 3, 1848, the U.S. Senate approved the Bidlack Treaty,<sup>669</sup> with Colombia giving the United States a right-of-way across Panama and naming the United States as the guarantor of Panamanian neutrality in the face of British territorial interests. Two years later, on April 19, 1850, the United States addressed British ambitions in Panama directly; the two countries signed the Clayton-Bulwer Treaty,<sup>670</sup> forswearing any occupations in Central America and pledging joint control over any future canal across Panama. Later, the United States persuaded the British to revise that agreement, opening the door for unilateral U.S. actions in Panama.

Panama has also showed signs of economic dependency throughout its history. Its first post-colonial economic boom began in 1848, thanks to the Gold Rush in the United States and the heightened demand from prospectors commuting between the U.S. East and West coasts. In 1850, U.S. investors began construction of a railroad across Panama that forever changed Panama's economy and population demographics. The \$9 million project had employed 5,000 Caribbeans, mostly from Jamaica, by the time construction finished on February 17, 1855.<sup>671</sup> Between 1856 and 1869, the foreign-owned, 47-mile long railroad carried 400,000 passengers,<sup>672</sup> and helped put Panama back on the map. As usual, however, Panama's economic dependency cut both ways. On May 10, 1869, in the United States, the Union Pacific Railroad Company joined the Central Pacific at Promontory, Utah, providing an alternative to the Panama railroad. Once again, however,

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<sup>669</sup> The treaty is named after the U.S. chargé d'affaires in Colombia, Benjamin Alden Bidlack.

<sup>670</sup> The treaty is named after Sir Henry Lytton Bulwer, the British minister to Washington, and U.S. Secretary of State John M. Clayton.

<sup>671</sup> Maurer, p. 43.

<sup>672</sup> Leonard 1993, p. 11.

Panama attracted a foreign economic lifeline. The \$260 million French canal-building efforts (1879 to 1884) buoyed Panama's economy. The French effort ultimately failed. But fortunately for Panamanians, the United States never lost interest. During the Spanish-American War, in 1898, the difficulties faced by Caribbean-bound U.S. ships leaving the U.S. West Coast hit home. The American battleship Oregon's closely watched, 68-day journey from San Francisco, Calif. to Key West, Fla. convinced U.S. authorities of the urgent need for a water route across Panama.

Of course, Panama eventually earned its independence, on November 6, 1903. However, as discussed, its national liberation was a gift from the U.S. government. Or perhaps more accurately, a trade for the famously one-sided Hay-Bunau-Varrila Treaty of 1904. All in all, it was an inauspicious start for the political independence of independent Panama. Panama had appointed a French engineer, Philippe-Jean Bunau-Varilla, as its envoy to the United States. Bunau-Varilla owned shares in a firm that controlled the remaining assets of the *Compagnie Universelle*, the French company that had attempted unsuccessfully to build a canal in Panama. In his eagerness to unload those assets, Bunau-Varilla negotiated a treaty that not only gave away the rights to the Panama Canal Zone, but turned the whole of Panama into a U.S. protectorate.<sup>673</sup> To make matters worse, he signed the agreement before the Panamanian negotiators had arrived in the United States. It showed. Article 1 bluntly declares: "The United States guarantees and will maintain the

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<sup>673</sup> There was a local precedent for a significant level of institutionalized U.S. influence in the affairs of another sovereign nation. The U.S. victory in the Spanish-American War, in 1898, forced Spain, in the Treaty of Paris, to renounce its claims to Cuba (and Guam, Puerto Rico and the Philippines). Cuba, however, did not emerge wholly untethered from a foreign power. In 1901, with U.S. troops still in Cuba, U.S. Senator Orville H. Platt, Republican of Connecticut, insisted that the United States retain a permanent right to intervene in Cuban affairs (as well as a naval base on Guantánamo Bay, Cuba). Under pressure, Cuba incorporated Platt's language into its constitution.

independence of the Republic of Panama.”<sup>674</sup> Panama, offered \$10 million and a \$250,000 annual rent,<sup>675</sup> ratified the treaty without even a Spanish translation.<sup>676</sup> Next, for independent Panama’s first constitution, Panama’s 32-member constituent assembly in 1904 codified the U.S. right of intervention (Article 136), bowing to U.S. demands.<sup>677</sup> Panama also granted the United States primary responsibility for Panama’s defense. “The consequence of Panama’s emancipation from Bogota was, therefore, its vassalage to Washington.”<sup>678</sup> In some ways, the situation was even worse than Panama’s subservience to Spain and later Colombia; Panama, it turned out, had “traded a weak, inefficient oppressor for a large and effective one.”<sup>679</sup>

Had independent Panama flourished outside the Panama Canal Zone, it might have avoided a reputation as a Caribbean basket case. Instead, Panamanian politics were chaotic from the start. That instability invited frequent U.S. intervention under the 1904 Panama Canal treaty, cementing Panama’s international image as incapable of self-governance. The U.S. military intervened in Panama in 1908, 1912, 1918 and 1925. The United States – often invited by one or another group of Panamanian elites – guided Panama through countless economic, political and security dramas. To exert further influence, U.S. canal authorities reserved 60 middle management positions for Panamanian elites.<sup>680</sup> The United States, which favored Panama’s conservative political movement, did not only intervene during crises; U.S. diplomats and U.S. canal authorities

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<sup>674</sup> Text of the Hay-Bunau-Varilla Treaty, Yale Law School library Web site, [http://avalon.law.yale.edu/20th\\_century/pan001.asp](http://avalon.law.yale.edu/20th_century/pan001.asp).

<sup>675</sup> The \$250,000 figure matched the annual payment to Panama for the railroad concession.

<sup>676</sup> Maurer, p. 85.

<sup>677</sup> Ibid., p. 86.

<sup>678</sup> Major, John. “The Panama Canal Zone, 1904–79.” In *The Cambridge History of Latin America*, edited by Leslie Bethell. Vol. 7. Cambridge, United Kingdom: Cambridge University Press, p. 645.

<sup>679</sup> J. Michael Hogan, *The Panama Canal in American Politics: Domestic Advocacy and the Evolution of Policy* (Carbondale, Ill.: Southern Illinois University Press, 1986), p. 64.

<sup>680</sup> Leonard 1993, p. 19.

supervised Panamanian elections and lobbied lawmakers. In 1916, the U.S. Navy confiscated high-powered rifles belonging to Panama's national police, determining locals could not be trusted with that firepower. On another occasion, the United States directed Panamanian police to break up meetings of non-U.S. canal employees who were organizing to demand higher wages. Not only did the United States guide Panamanian politics, but it also kept Panama's economy afloat through canal wages and the local procurement of coffee, cattle, sugar, rum and other products.<sup>681</sup> (Canal income always helped, though it was inconsistent; for example, the end of canal construction and World War One bludgeoned Panama's economy, with the United States laying off thousands of canal workers and cutting salaries.) Remarking upon the U.S. role in Panama, a British diplomat once observed, "It is really farcical to talk of Panama as an independent state. It is really simply an annex of the Canal Zone."

### **Arnulfo Arias's Revolving Door**

For better or worse, the United States did not micromanage Panamanian politics. Panama's homegrown political activities also contributed to its image – not uncommon in a region that suffered from warlordism and civil conflict after independence – as a careless, unsophisticated, hopelessly corrupt society that could not be trusted to manage the canal. In Sen. Thurmond's estimate, Panama recorded 59 president in 70 years,<sup>682</sup> "a game of musical chairs among the nation's most prestigious families."<sup>683</sup>

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<sup>681</sup> Other benefits to Panama, highlighted by Falcoff, included U.S. supplied drinking water for Panama City; road and bridge construction throughout Panama by U.S. army engineers; low inflation thanks to Panama's use of the U.S. dollar; a relatively high level of foreign investment thanks to the stabilizing presence of the United States; and the spread of English, making Panama's workforce more competitive.

<sup>682</sup> Walter LaFeber, *The Panama Canal: The Crisis in Historical Perspective* (Oxford, United Kingdom: Oxford University Press, 1989), p. 145.

<sup>683</sup> Leonard 1993, p. 26.

The most symbolic, and notorious, example was Panama's on-again, off-again romance with Arnulfo Arias. In 1940, Panamanians selected as their president Arias, a University of Chicago and Harvard Medical School graduate with diplomatic experience in Germany and Italy. His leadership style took inspiration from Hitler and Mussolini, as did his foreign policy. Critics mocked him as the "Creole Führer." His constitutional reforms curtailed the rights of non-white Panamanians, and his policy platform included uniforms for teachers and students; fines for bars where the playlist leaned too heavily on foreign musicians; and the forced sale of foreign-owned companies to Panamanian investors. Arias's first term as president lasted just a year; in 1941, while he was in Cuba visiting his mistress, opponents forced him from office and briefly jailed him, before permitting him to leave Panama for Managua, Nicaragua, and later settle in Buenos Aires, Argentina. In 1949, Arias regained the presidency. This time around, it was Arias's corruption and nepotism, more than his nationalism and racism, that raised eyebrows. Arias liberally appointed relatives to public jobs;<sup>684</sup> forced banks to approve personal loans; bullied political opponents to sell assets cheaply; and seized Panama's largest coffee plantation. Soon, Panamanian elites once again tired of Arias's rule. On May 10, 1951, the Panamanian legislature impeached Arias. After he refused to step down, Panamanian police, in a bloody raid, forcibly evicted him and 500 of his supporters from the presidential palace and jailed him for a year. Remarkably, impeachment and imprisonment did not end Arias's political career. In 1968, he won the Panamanian presidency for the third time. His third term, however, lasted just 11 days; on October 11, 1968, Panama's National Guard deposed Arias and installed a military dictatorship. In

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<sup>684</sup> Arias was hardly the first Panamanian president to bestow public jobs on relatives. After all, he had served as minister of agriculture and public works during the presidency of his brother, Harmodio.

Arias's three terms as president,<sup>685</sup> he had only managed to spend two and a half years in office, while logging two years in jail and 15 years in exile.

### **Too Close for Comfort**

Panama's unhappy relationship with the United States also contributed to the jaundiced view in the United States of the Panamanian government and people, and the lack of confidence in Panama's capacity to replace the United States as the canal's caretaker. In many ways, the U.S.-Panamanian relationship was doomed from the start. The U.S. government sought credit for delivering Panamanian independence, building the canal that put the new republic on the map, and providing an economic lifeline. So Panama's constant griping and chronic underdevelopment did not endear Panamanians to the U.S. public. Panamanians, not surprisingly, saw things differently. In their view, the United States had strong-armed a tiny country into trading away 500 square miles of its most valuable land, and then ignored its pleas for justice for generations.

It is doubtful that most Americans ever reflected on the U.S. relationship with Panama, at least not until President Jimmy Carter came along. Now and again, however, Panama found its way into U.S. newspapers, and it was rarely a friendly headline. Panama began protesting the 1904 canal treaty almost immediately, particularly the broad rights granted to the United States. Article III of the agreement, for example, promised the United States all rights in the Panama Canal Zone that it would have enjoyed "if it were the sovereign of the territory within which said lands and waters are located, to the entire exclusion of the exercise by the Republic of Panama of any such sovereign rights,

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<sup>685</sup> Arias served as president from June 1940 to October 1941; November 1949 to May 1951; and October 1 to 12, 1968.



power or authority.”<sup>686</sup> As buyer’s remorse set in, President Theodore Roosevelt (1901 to 1909) sought to reassure Panama that the United States had no intention of establishing a colony in Panama.<sup>687</sup> In a letter to Secretary of War William Howard Taft instructing Taft to visit Panama to ease tensions, Roosevelt said Panamanians had become “unduly alarmed” by the institutionalization of the U.S. presence in the Panama Canal Zone.<sup>688</sup> Despite the admittedly generous terms of the treaty, Roosevelt assured Taft, “it is our full intention that the rights which we exercise shall be exercised with all proper care for the honor and interests of the people of Panama.”<sup>689</sup>

It is hard to find a Panamanian who believes the United States lived up to Roosevelt’s promise. Rather, Panamanians generally saw the U.S. presence in Panama, for all the economic advantages, as deeply irritating. Now and again, U.S. authorities acknowledged Panamanian discontent, usually following a public outburst against the U.S. canal authorities. On March 2, 1936, Franklin D. Roosevelt (1933 to 1945), Theodore Roosevelt’s cousin, applied his “Good Neighbor” policy to Panama and agreed to modify the 1904 canal treaty. Satisfied with the results of 110 negotiating sessions,<sup>690</sup> Roosevelt, in the Hull-Alfaro Treaty, relinquished the controversial U.S. right to intervene in Panamanian affairs. To support Panamanian merchants, Roosevelt also agreed to reduce sales from the Panama Canal Zone’s duty free commissaries to Panamanian citizens. The agreement, signed by U.S. Secretary of State Cordell Hull and

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<sup>686</sup> Hay-Bunau-Varilla Treaty.

<sup>687</sup> William J. Jorden, *Panama Odyssey* (Austin, Texas: University of Texas Press, 1984), p. 25.

<sup>688</sup> “President to Send Taft on Mission to Panama,” *The New York Times*, October 20, 1904.

<sup>689</sup> In Panama, Taft assured Panamanians, “we have not the slightest intention of establishing an independent colony in the middle of the state of Panama, or of exercising any greater governmental functions than are necessary to enable us, conveniently and safely, to construct, maintain and operate the canal.”

<sup>690</sup> Leonard 1993, p. 75.

Panama's foreign minister, Ricardo Alfaro, also increased the Panama Canal Zone annual rent from \$250,000 to \$430,000.

However, in a pattern that would persist for decades, U.S. officials did not trust their Panamanian counterparts, and so U.S. concessions did little to repair the bilateral relationship. For example, in 1945, at the Potsdam conference,<sup>691</sup> President Harry S. Truman (1945 to 1953) mused about transferring the Panama Canal to UN control, but he dismissed any plan to let Panama take charge. "The United States did not trust Panamanian governments. If a future Panamanian government was likely to have malign intent – or be unable to operate the canal efficiently, which was very close to the same thing – thereby forcing the United States to intervene again, why leave in the first place and risk the collateral damage?"<sup>692</sup> U.S. officials continued to show some flexibility. On January 25, 1955, the United States, under President Dwight D. Eisenhower (1953 to 1961), once again agreed to modify the canal relationship. This time, the United States increased the Panama Canal Zone annual rent from \$430,000 to \$1.9 million; completely restricted commissary sales to U.S. personnel; permitted Panama to tax Panamanians employed by the U.S. canal administration; and ended a policy that linked canal employee salaries to nationality. Eisenhower was no doubt spooked by Egypt's nationalization of the Suez Canal in 1956, and statements by Egyptian President Gamal Abdel Nasser (1956 to 1970) calling on the UN to take over the Panama Canal.<sup>693</sup> Following anti-American riots in Panama in 1959, Eisenhower succumbed to

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<sup>691</sup> The Potsdam conference, held outside Berlin, Germany, involved Allied leaders Harry S. Truman, British Prime Minister Winston Churchill and the Soviet premier, Joseph Stalin.

<sup>692</sup> Mauer 2010, p. 228.

<sup>693</sup> John Major, *Prize Possession: The United States Government and the Panama Canal 1903-1979* (Cambridge, United Kingdom, 1993), p. 374.

Panamanian demands to fly the Panamanian flag in the Panama Canal Zone in recognition of Panama's "titular sovereignty" over the U.S.-controlled territory.

Still, tensions remained high. For one, Panama continued to complain about the paltry Panama Canal Zone annual rent, insisting the United States could afford to be more generous if only it would reconsider its rigid canal toll policy. After all, the canal had dramatically reduced the cost of freight – the rate between Liverpool, England and the U.S. West Coast had fallen by 27 percent by 1920,<sup>694</sup> for example – but the United States refused to raise tolls for 60 years. For Panama, it was clear that the United States was subsidizing U.S. companies, such as southern California oil drillers and Pacific Northwest lumber mills, at Panama's expense.<sup>695</sup> (Other canal users also benefited, including Japanese importers of U.S. cotton and Chile's nitrate and copper exporters.) Ships sailing between the East and West Coasts of the United States saved 8,000 nautical miles by avoiding the trip around Cape Horn. Meanwhile, Panama settled for the crumbs of the canal industrial complex. The United States prohibited Panama from taxing non-Panamanian canal employees,<sup>696</sup> or the wide array of goods and services sold at Panama Canal Zone commissaries, including a wholesale dry goods store; cigar shops; a tailor; an ice cream factory; hotels; coaling stations; fruit and produce farms; a coffee roaster; stables; a printer; a milk bottling plant; a sausage factory; a pickling department; and even a cattle ranch and slaughterhouse.<sup>697</sup> Before Eisenhower, these Panama Canal Zone businesses had served not only canal employees, but also contractors and even transiting

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<sup>694</sup> Mauer 2010, p. 142.

<sup>695</sup> The opening of the canal broke the monopoly of the railroads for transporting a variety of goods. It was a particular boon to U.S. oil producers. In February 1923, two oil tankers crossed the canal daily, and the number rose to five by April 1923. In 1924, a third of California's oil passed through the canal.

<sup>696</sup> Mauer 2010, p. 190.

<sup>697</sup> Ibid., p. 192.

passengers.<sup>698</sup><sup>699</sup> That unpopular practice not only deprived Panama of tax revenue, but it also diverted business from Panamanian competitors outside the Panama Canal Zone, who had to pay taxes and did not enjoy subsidized fares on the Panama Canal Railroad.<sup>700</sup> (For the United States, by contrast, the commercial enterprises had the benefit of employing the growing number of offspring of canal employees.<sup>701</sup>) There were other economic sources of tension. Canal zone housing competed with Panamanian-owned apartments. U.S. canal workers enjoyed a 25 percent wage differential and received payment in gold, rather than the silver coins distributed to Panamanian and Caribbean canal workers. The canal zone geography also frustrated Panama, limiting the expansion of the terminal cities, Colón and Panama City. The economic inequality was awkward; an archbishop of Panama, Marcos McGrath, once observed that Panama's "teeming tenements face across the street a fence and open fields or virgin jungles, space unused, space reserved, space denied." As the United States developed the Panama Canal Zone territory, Panama itself remained "a jungle and farm area athwart the U.S. canal zone."<sup>702</sup>

Panamanians also chafed at the presence of so many U.S. troops. The 1904 canal treaty had assured U.S. rights to deploy U.S. troops to defend the canal and even to establish fortifications for that purpose.<sup>703</sup> Still, it was clear the United States was liberally interpreting that mandate: During World War Two, for example, the U.S. armed

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<sup>698</sup> Ibid.

<sup>699</sup> In the early days of canal construction, the canal administration found few opportunities for local procurement. In his 1905 annual report, Charles E. Magoon, the canal zone governor, lamented, "such fare as the better class of Americans are accustomed to cannot be obtained in Panama at any price." The supposedly poor performance of Caribbean workers, he explained, likely resulted from malnutrition.

<sup>700</sup> Mauer 2010, p. 193.

<sup>701</sup> Marshall Edward Dimock, *Government-operated Enterprises in the Panama Canal Zone* (Chicago, Ill.: The University of Chicago Press, 1934), p. 7.

<sup>702</sup> Denison Kitchel, *The Truth about the Panama Canal* (New Rochelle, N.Y.: Arlington House, 1978), p. 83.

<sup>703</sup> Hay-Bunau-Varilla Treaty, Article 23.

forces established the U.S. Southern Command<sup>704</sup> in the Panama Canal Zone, with an explicit responsibility for all of Latin America. In 1946, the United States opened the School of the Americas in the canal zone, offering training to security forces from across the hemisphere.<sup>705</sup> Panama considered these and other U.S. military facilities illegal.<sup>706</sup> U.S. military construction in the zone peaked during World War Two, when the United States built 134 defense installations.<sup>707</sup> By the late 1970s, however, the United States still had seven bases in the Panama Canal Zone,<sup>708</sup> housing 9,300 personnel. The canal, meanwhile, has never come under attack, by Panamanians or foreigners (though during World War Two, the Japanese planned a submarine assault on the waterway that would have involved the 400-foot long, I-400 megasub).<sup>709</sup>

In 1958, the president's brother, Milton Eisenhower, traveled to Panama to evaluate the situation. One hundred angry high school students protested his visit at the U.S. Embassy, one holding a sign demanding, "Milton, Go Back to U.S.A."<sup>710</sup> He returned warning his brother of an "impending disaster."<sup>711</sup> Indeed, Panamanians were soon registering their grievances on the street yet again; on November 3, 1959, Panamanian independence day, a group of protestors marched toward the canal zone, while others torched cars, tore down the U.S. flag at the U.S. Embassy,<sup>712</sup> and shattered embassy windows with stones. The U.S. Congress was not amused. Predisposed to

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<sup>704</sup> The Southern Command, known as SOUTHCOM, is now based in Doral, Fla., a half hour west of Miami. It left Panama in 1997.

<sup>705</sup> The School of the Americas, now called the Western Hemisphere Institute for Security Cooperation, is now based at Fort Benning, Ga. (The name change reflects its notorious reputation among human rights advocates for its alleged role in supporting the repression of dissent by Latin American dictatorships.)

<sup>706</sup> Bethancourt 1981, p. 263.

<sup>707</sup> Leonard 1993, p. 80.

<sup>708</sup> The bases included Albrook Air Force Station; Howard Air Force Base; Fort Amador; Fort Clayton; Fort Davis; Fort Gulick; Fort Kobbe; and Rodman Naval Station.

<sup>709</sup> Lucero, Louis II, "Finding Japan's Aircraft-Carrier Sub," *The New York Times*, December 2, 2013.

<sup>710</sup> Kennedy, Paul P., "100 Protest Visit of Dr. Eisenhower," *The New York Times*, July 15, 1958.

<sup>711</sup> Jorden 1984, p. 28.

<sup>712</sup> Mauer 2010, p. 236.

oppose Panamanian demands, bolstered by public opinion and unmoved by Panamanian attempts at intimidation, the House of Representatives voted 380 to 12 for a resolution opposing the Panamanian demand for Panama's flag to fly in the canal zone.<sup>713</sup>

Once again, however, the United States sought to address Panamanian frustration, though still without satisfying Panama's core demands or building trust between the two countries: On September 21, 1960, the United States raised the Panamanian flag at Shaler Triangle,<sup>714</sup> on Fourth of July Avenue, by Panama's Legislative Palace.<sup>715</sup> The goodwill gesture left Panama's new president, Roberto Chiari (1960 to 1964), with plenty of unresolved grievances, which he expressed in a lengthy letter to President John F. Kennedy (1961 to 1963) in September 1961. That letter prompted Kennedy to order the State Department to review U.S. canal policy.<sup>716</sup> Kennedy never called for a new canal treaty, but in a classified memorandum to his secretary of state, Dean Rusk, Kennedy said the United States "must recognize, however, that this question cannot be postponed indefinitely."<sup>717</sup> Later, Kennedy invited Chiari to Washington, and the two leaders met in June 1962. Following their conversation, Kennedy replaced the canal governor and set up a task force to study the issue and advise a binational commission that had been established to improve relations. In a classified memorandum, he told Rusk, Defense Secretary Robert S. McNamara and Secretary of the Army Elvis Jacob Stahr Jr. that he

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<sup>713</sup> Jorden 1984, p. 30.

<sup>714</sup> Shaler Triangle was named for James Shaler, the U.S. railroad superintendent who helped Panama secede from Colombia by preventing Colombian troops from responding to the Panamanian rebellion. On October 24, 1963, the United States also raised the Panamanian flag at the Miraflores locks, and it did so at the Gatún locks on November 9, 1963.

<sup>715</sup> Jorden 1984, p. 31.

<sup>716</sup> Papers of John F. Kennedy. Presidential Papers. National Security Files. Meetings and Memoranda. National Security Action Memoranda: 95, Renegotiation of Panama Canal Treaty. John F. Kennedy Presidential Library and Museum.

<sup>717</sup> John. F. Kennedy, National Security Action Memorandum 152, Panama Canal Policy and Relations with Panama, 1962, National Security Archive.

expected “concrete results” from the policy review.<sup>718</sup> Kennedy’s interest in the subject reflected not only Chiari’s persistence, but also the constant threat of unrest in Panama. On February 22, 1963, Chiari had warned Kennedy that the slow pace of negotiations “makes me fear that at any moment, given the favorable circumstances, it might lead to dangerous popular demonstrations.”<sup>719</sup> Around the same time, a National Security Council aide, James S. Lay Jr., distributed a memorandum warning his White House colleagues of the threat of sabotage at the Panama Canal amid rising nationalism in Panama and a desire among Panamanian leaders to use the United States as a “whipping boy.” A senior State Department official, Executive Secretary William H. Brubeck, expressed a similar concern to National Security Adviser McGeorge Bundy in a classified July 17, 1963 memorandum: “There are signs that the Government of Panama may soon feel itself obliged to engage in precipitous action which might disrupt the calm which now prevails in our relationship.” However, despite his exchanges with Chiari and the specter of violence, Kennedy did not agree to revise the 1903 canal treaty. In a letter to Chiari dated April 30, 1962, Kennedy promised only “interim measures” to improve the diplomatic relationship.<sup>720</sup> For example, he agreed to build a bridge over the canal, a longtime Panamanian demand, and increased the locations in the Panama Canal Zone where Panama could fly its flag. After his death on November 22, 1963, it became clear that Kennedy’s approach had only raised Panamanian expectations and worsened the relationship.

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<sup>718</sup> John. F. Kennedy, National Security Action Memorandum, Problems Arising Out of U.S. Relationship with Panama from the Canal and Canal Zone, 1962, National Security Archive.

<sup>719</sup> Chiari had been growing increasingly frustrated with Kennedy. In a letter sent May 17, 1962, Chiari complained about the “interminable and hitherto fruitless discussions” over the canal.

<sup>720</sup> John. F. Kennedy, Letter to President Roberto Chiari, April 30, 1962.

## **Panamanian Powder Keg**

Not long after the Kennedy assassination, on December 30, 1963, the canal zone governor, Robert J. Fleming Jr., announced new flag regulations. This time, it was poor enforcement that led to the next clash. Fleming's policy prohibited any flags at the 1,851-student Balboa High School. But on January 7, 1964, U.S. students raised the stars and stripes and soon afterward, other U.S. flags were flying in undesignated areas throughout the zone.<sup>721</sup> Panamanian students at the Instituto Nacional bristled at the loss of the hard-fought flag concessions. On January 9, 1964, they marched on the zone. At 4:45 p.m., after class let out, 200 Panamanian students poured onto Gorgas Road and headed toward Fleming's residence, where they shouted slogans and sang the Panamanian national anthem.<sup>722</sup> That group met no resistance, but other students who headed for Balboa High School encountered Panama Canal Zone police and U.S. students who belted out the U.S. national anthem and prevented the raising of the Panamanian flag. The young Panamanians retreated; as they marched off, they pelted the nearby Panama Canal Administration Building with stones, shouting, "You will live to regret this."<sup>723</sup> That night, as news of the altercation spread, thousands of Panamanian protestors again headed down Fourth of July Avenue toward the canal zone. Never was heard a discouraging word from Panama's National Guard, despite pleas from U.S. authorities, and soon the mob was attacking a U.S. judge's residence with rocks and Molotov cocktails; setting fire to a bus terminal, and attacking the canal zone firefighters who had been called in to respond.<sup>724</sup>

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<sup>721</sup>Jorden 1984, p. 36.

<sup>722</sup> Ibid., p. 40.

<sup>723</sup> Ibid., p. 42.

<sup>724</sup> Ibid., p. 46.



Overwhelmed, the Panama Canal Zone police asked for help from the Southern Command. The U.S. armed forces eventually restored calm inside the zone, and Panama's National Guard finally stopped the rioting outside the zone, on January 13, 1964. But by then, the damage was catastrophic: (1) U.S. security forces had killed 22 Panamanians, including 20-year-old Ascanio Arosemena, the captain of the soccer team at the Escuela Profesional and an instant martyr for Panamanian activists; (2) looters in Panama City had ransacked a U.S.-run library, burning 12,000 books, destroyed buildings belonging to U.S. companies, such as Pan American Airways, and set upon cars with Panama Canal Zone license plates, in some cases beating their occupants; (3) Panamanian snipers on the Atlantic side of the canal had fatally shot Pvt. David Haupt, Staff Sgt. Luis Jimenez Cruz and Sgt. Gerald Aubin;<sup>725</sup> (4) and the 1,000 bullets Panamanians had fired into the zone,<sup>726</sup> coupled with the protestors' rocks, bottles and clubs, had injured many other U.S. nationals. On January 17, 1964, Chiari broke diplomatic relations with the United States. Predictably, the United States did not react well to the riots, or to Panama's hard line approach in the aftermath. The Senate minority leader, Everett Dirksen, warned on the Senate floor that "we are in the amazing position of having a country with one-third the population of Chicago kick us around. If we crumble in Panama, the reverberations of our actions will be felt around the world."<sup>727</sup> Kennedy's successor, Lyndon B. Johnson (1963 to 1969), had a similar reaction to the riots and Chiari's aggressive posture. "Having failed through diplomacy with President Kennedy, Chiari was going to try to exact a new treaty from me by force," Johnson

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<sup>725</sup> Ibid., p. 53.

<sup>726</sup> Ibid., p. 77.

<sup>727</sup> Ibid., p. 74.

recalled in his memoirs.<sup>728</sup> To observers outside the U.S. government, the prospects for a new canal treaty also appeared remote. “No one can expect the United States to walk away and leave millions of dollars in military, naval and air force installations in the canal zone,” University of Akron historian Sheldon B. Liss wrote in 1967.<sup>729</sup>

### **LBJ, Nixon, Ford**

Despite the growing disdain for Panama in the United States, layered atop the general mistrust of the Panamanian people, Johnson quickly sent a delegation to address the diplomatic impasse. By April 3, 1964, he had persuaded Chiari to restore diplomatic relations. In a statement that day, Johnson said, “Panama can be confident, as we are confident, that we each desire an agreement which protects the interests and recognizes the needs of both our nations.” For the first time, the U.S. government began serious negotiations over replacing the 1903 Panama Canal treaty. In a televised address in December 1964, Johnson publicly committed to a new treaty.<sup>730</sup> He appointed Robert B. Anderson, Eisenhower’s former treasury secretary, as his special representative to the Panama talks, and he made sure negotiations continued after Panamanian President Marco Robles (1964 to 1968), a Chiari ally, took office. A classified summary of a U.S. government Panama working group meeting, dated July 29, 1963, noted continued U.S. opposition to a major revision of the canal treaty. Nevertheless, on December 18, 1964, Johnson once again publicly committed to a “new treaty.”<sup>731</sup> Johnson’s politically risky approach opened the door to three tentative agreements with Panama, reached in 1967,

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<sup>728</sup> Lyndon B. Johnson, *The Vantage Point, Perspectives of the Presidency, 1963-1969* (New York City, N.Y.: Holt, Rinehart and Winston, 1971), p. 183.

<sup>729</sup> Sheldon B. Liss, *The Canal: Aspects of United States-Panamanian Relations* (Notre Dame, Ind.: University of Notre Dame Press, 1967), p. 223.

<sup>730</sup> Michael L. Conniff, *Panama and the United States: The Forced Alliance* (Athens, Ga.: University of Georgia Press, 1992), p. 122.

<sup>731</sup> *Ibid.*, p. 102.

that promised U.S. supervision of canal operations would cease in 1999; in the interim, according to the agreements, a binational commission would run the waterway. The progress was promising; indeed, in broad terms, President Jimmy Carter's canal treaties, a decade later, would mirror the terms of Johnson's tentative 1967 agreements. Johnson was so interested in the canal issue that he personally lobbied members of Congress for support.<sup>732</sup> Ultimately, however, the U.S. Senate never considered the agreements, as Johnson was replaced by Nixon in the United States and in Panama, Arnulfo Arias returned to power for his short-lived final term.

Despite the progress under Johnson and Robles, the stage was set for a return to the traditional tension and dysfunction of the U.S.-Panamanian relationship. Panamanian hardliners had immediately criticized the Johnson agreements. Then, Panamanians in 1968 yet again elected the controversial Arnulfo Arias. His election destabilized Panamanian politics, leaving no opportunity for serious negotiations over the canal to resume. In the United States, where Johnson had opted out of the 1968 election, U.S. officials had no love for Arias. Yet Arias's removal, in the October 11, 1968 National Guard coup, did not improve the bilateral relationship. For one, the United States objected to Arias's undemocratic removal; Secretary of State Dean Rusk called the coup "disturbing,"<sup>733</sup> and the United States granted Arias and his cabinet asylum in the Panama Canal Zone and later settled him in Florida, after no Latin American governments offered to take him in.<sup>734</sup> In the middle of all this, Panama's new leader, Omar Torrijos, came to power with little warmth or trust for the United States. Torrijos had never held the United States in high regard; as a boy, he witnessed U.S. police officers bullying his mother as

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<sup>732</sup> Ibid., p. 110.

<sup>733</sup> "Rusk Voices His Concern as Relations Are Suspended," *The New York Times*, October 13, 1968.

<sup>734</sup> Welles, Benjamin, "Latin Asylum Asked for Arias by U.S.," *The New York Times*, October 17, 1968.

they crossed the Panama Canal Zone. U.S. support for the ousted Arias put Torrijos immediately at odds with the United States. If the U.S. government attempted to reinstate Arias, Torrijos warned, he would “burn the canal zone”<sup>735</sup> – the first in a steady stream of threats he would send northward. In December 1969, while Torrijos vacationed in Mexico, three officers attempted a coup, and Torrijos later blamed the United States after the failed coup plotters escaped to Miami.<sup>736</sup>

Torrijos, a ruggedly handsome soldier and populist leader, managed to win fans in the United States and abroad. His grandiosity felt somehow too large for diminutive Panama, so he obsessively wooed international figures. The leftist novelist Gabriel García Márquez was a fan, but so was the conservative U.S. intellectual William F. Buckley Jr., who visited Panama in 1976 and became a surprisingly vocal backer of a canal turnover.<sup>737</sup> John Wayne, a frequent traveler to Panama for fishing trips – his first wife was Panamanian – also endorsed the canal turnover. At one point, the legendary actor issued a three-page statement about the canal that he sent to every U.S. senator,<sup>738</sup> provoking the first hate mail of his career. Wayne was apparently embarrassed by the relentless mockery of Panama by U.S. elites.<sup>739</sup> On at least one occasion, he traveled to Panama to help Torrijos entertain visiting U.S. senators,<sup>740</sup> and he drafted letters and op-eds defending the canal turnover. In a letter to Reagan, dated November 11, 1977 and addressed to “Ronnie,” Wayne accused the former California governor of “misinforming people” and demanded that he “take a look at the difference between point of view and

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<sup>735</sup> Jorden 1984, Introduction.

<sup>736</sup> Ibid., p. 146.

<sup>737</sup> Ibid., p. 459.

<sup>738</sup> Ibid., p. 490.

<sup>739</sup> William Furlong and Margaret Scranton, *The Dynamics of Foreign Policymaking: The President, the Congress and the Panama Canal Treaties* (Boulder, Colo.: Westview Press, 1984), p. 153.

<sup>740</sup> Don Bohning, “Who Remembers Panama? Returning the Canal,” *ReVista*, Spring 2013.

facts.”<sup>741</sup> Starting in 1976, the British novelist Graham Greene also began visiting Torrijos in Panama, invited by Torrijos, who furnished first class tickets.<sup>742</sup> After several trips, Greene had “grown to love” the general whom he called “Omar” and whose friendship he described in a flattering memoir, “Getting to Know the General: The Story of an Involvement.”<sup>743</sup> Greene admired Torrijos’s modest lifestyle; the general dressed in military fatigues, lived in an “insignificant suburban house,”<sup>744</sup> and settled for Johnnie Walker Black label.<sup>745</sup> He was also impressed by Torrijos’s optimism – Greene called it a “charisma of near despair” – throughout Panama’s David and Goliath struggle. Most often, Greene spent his visits downing cups of rum punch and palling around with Torrijos’s entourage in Panama City. But he also traveled to the countryside, observing Torrijos in dialogue with yucca farmers and concluding that Panama’s dictatorship was a superior brand of democracy. For Greene, Torrijos’s attention seemed to have the same effect as the candy Torrijos handed out to village children: Torrijos, Green gushed in his memoir, “grasped at friendship as greedily as he grasped at books, as though there were too little time left for him to catch up on either.”<sup>746</sup> Later, for the signing of the Carter-Torrijos Panama Canal treaties in Washington, Greene and Márquez both accompanied Torrijos, where Torrijos read a speech Greene helped write.<sup>747</sup>

Torrijos also had fans in the White House. Kissinger admired Torrijos’s brinkmanship, how he “tended to play with fire, but knew at every step exactly where the

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<sup>741</sup> John Wayne’s letter to Ronald Reagan is archived at the Jimmy Carter Presidential Library and Museum in Atlanta, Ga.

<sup>742</sup> Graham Greene, *Getting to Know the General: The Story of an Involvement* (London, United Kingdom: The Bodley Head, 1984), p. 28.

<sup>743</sup> Ibid., p. 13.

<sup>744</sup> Ibid., p. 32.

<sup>745</sup> Ibid., p. 36.

<sup>746</sup> Ibid., p. 181.

<sup>747</sup> Ibid., p. 130.

fire brigade could be found.”<sup>748</sup> Following Carter’s election, Torrijos forecast a “great and profound friendship” with the new U.S. president,<sup>749</sup> who shared his rural upbringing.<sup>750</sup> Indeed, the unlikely pair developed a trusting relationship. (Carter also drew close to Torrijos’s ambassador to the United States, Gabriel Lewis Galindo, a paper box magnate and the developer of Contadora Island.<sup>751</sup> Lewis was a constant presence in the Oval Office and the halls of Congress. He and his wife were also the pit crew for Panama’s canal negotiators, whom they fueled on Saturdays with platters of liver with onions, and scrambled eggs with tomatoes.<sup>752</sup>) “Panama without Torrijos most likely would have been an impossible negotiating partner,” Zbigniew Brzezinski, Carter’s national security adviser, said.<sup>753</sup> Carter called Torrijos “the most effective salesman” for the canal treaties.<sup>754</sup> “The more my colleagues and I learned about this man, the greater the respect and affection we had for him,” he said.<sup>755</sup> “No one could have handled the affairs of Panama and its people more effectively than had this quiet and courageous leader.”<sup>756</sup> At a White House meeting on September 6, 1977, Vice President Walter Mondale presented Torrijos a baseball bat signed by Rod Carew, the famed Panamanian infielder on the Minnesota Twins.<sup>757</sup> Carter’s canal negotiator, Sol M. Linowitz, also showered praise on Torrijos, an “intuitive politician of great native intelligence, in his

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<sup>748</sup> Henry Kissinger, *Years of Renewal* (New York City, N.Y.: Simon & Schuster, 1999), p. 715.

<sup>749</sup> Jorden 1984, p. 359.

<sup>750</sup> “Torrijos had developed a theory that because he and Carter were both farmers, they understood the world the same way,” Carter’s canal negotiator, Sol M. Linowitz, said.

<sup>751</sup> Lewis’s U.S. counterpart, William Jorden, shared Carter’s bottomless admiration for Lewis, whom Jorden described as “one of the most imaginative ambassadors ever to alight on the banks of the Potomac.”

<sup>752</sup> María Mercedes de la Guardia de Corró, *Gabriel Lewis Galindo: Hasta la Última Gota* (Cali, Colombia: Cargraphics, 2009), p. 98.

<sup>753</sup> Zbigniew Brzezinski, *Power and Principle: Memoirs of the National Security Advisor, 1977-1981* (New York City, N.Y.: Farrar, Straus, Giroux, 1983), p. 136.

<sup>754</sup> Jimmy Carter, *Keeping Faith: Memoirs of a President* (Toronto, Canada: Bantam Books, 1982), p. 164.

<sup>755</sup> *Ibid.*, p. 161.

<sup>756</sup> *Ibid.*, p. 179.

<sup>757</sup> Carew was born on October 1, 1945 in Gatún, in the Panama Canal Zone. He was inducted into the baseball Hall of Fame in 1991 with a .328 career batting average.

own way a philosopher.”<sup>758</sup> Torrijos’s meetings with U.S. officials often involved bear hugs.

Torrijos was not, however, an unblemished spokesman for Panama’s cause. He could be “callous and dictatorial,”<sup>759</sup> exiling opponents in the business community, quashing free speech and sanctioning arbitrary imprisonment and torture by his feared G-2 intelligence agency. He abolished political parties and stripped the congress and presidency of real authority. William Jorden, a U.S. ambassador to Panama who worked closely with Torrijos, called the general “tough, shrewd, egotistical, ill-educated, charismatic, incredibly patient, yet often volatile.”<sup>760</sup> Torrijos was “not highly organized, hated meetings, despised detail,” Jorden observed, and he “loved to drink and carouse.”<sup>761</sup> Torrijos, though an early riser,<sup>762</sup> disliked formality,<sup>763</sup> took meetings in a hammock<sup>764</sup> and enjoyed holding court in his bedroom, a Cuban cigar and Scotch and soda in hand.<sup>765</sup> Outsiders who knew him best remembered him as a “moody, introspective, emotional man,”<sup>766</sup> a “complicated mix of good and bad, of openness and mystery, sophistication and naiveté,”<sup>767</sup> an “unusual, erratic, sensitive, ill-educated, brilliant man.”<sup>768</sup> He was a spendthrift whose populist policies indebted Panama. He was highly emotional. Before the Carter-Torrijos treaty signing, standing backstage with the

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<sup>758</sup> Sol M. Linowitz, *The Making of a Public Man: A Memoir* (Boston, Mass.: Little, Brown 1985), p. 174.

<sup>759</sup> Jorden 1984, p. 314.

<sup>760</sup> Ibid., Introduction.

<sup>761</sup> Ibid., p. 141.

<sup>762</sup> Ibid., p. 202.

<sup>763</sup> Ibid., p. 225.

<sup>764</sup> Greene 1984, p. 149.

<sup>765</sup> Jorden 1984, p. 175.

<sup>766</sup> Ibid., p. 330.

<sup>767</sup> Ibid., p. 483.

<sup>768</sup> Ibid., p. 496.

U.S. president, Torrijos sobbed in his wife's arms.<sup>769</sup> To Reagan, Torrijos was always a "tinhorn dictator."<sup>770</sup> Regarded at home as a patriot, outsiders saw a power grab in Torrijos's canal obsession. "Torrijos and those entrenched in power in Panama covet the well drained and manicured real estate across the divisory line, which they hope will become their personal property when a new protocol is signed," one historian, Gustave Anguizola, wrote. Anguizola borrowed a line from a scout for Bolívar, who had said of Panama in 1826: "Here one lives in constant turmoil."<sup>771</sup> Some even questioned whether Torrijos truly wanted a treaty with the United States, as opposed to a politically useful, permanent conflict. Nor could supporters of the canal turnover try to minimize Torrijos's influence over Panamanian affairs: A portrait of Panama's "maximum leader" hung in every restaurant, bar, airport, hotel and store in the country.<sup>772</sup> Though focused on solving minor problems for isolated Indians in remote regions, Torrijos was clearly impatient for a grand achievement; "I don't want to enter into history, only the Panama Canal Zone," he was fond of saying.

Torrijos's eccentricities and peccadilloes were hardly Panama's only public relations headaches. Torrijos was also a loose cannon in his foreign policy. In 1974, for example, he recognized Cuba's communist government, antagonizing U.S. policymakers who had hoped to isolate the Castro regime. Next, Torrijos joined the Non-Aligned Movement<sup>773</sup> and also traveled to Cuba, arriving on January 10, 1976 and hugging Castro

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<sup>769</sup> Carter 1982, p. 161.

<sup>770</sup> Reagan's ally in the anti-treaty camp, Representative Crane, also favored that description. But Crane had more colorful language for Torrijos, a head of state he called a "short, swarthy man," a "crude, unstable leader" and the "Latin American echo of Idi Amin."

<sup>771</sup> Gustave Anguizola, *The Panama Canal: Isthmian Political Instability from 1821 to 1977* (Washington, D.C.: University Press of America, 1977), p. 75.

<sup>772</sup> LaFeber 1989, p. 125.

<sup>773</sup> The Non-Aligned Movement, with more than 100 member states, purports to represent the interests of developing countries. It developed in 1961, during the Cold War, to provide a political space for



at the airport. (In appreciation, Castro kept Torrijos supplied with Cuban cigars with Torrijos's name printed on the band.<sup>774</sup>) In April 1977, Torrijos added Libya to his travel agenda, meeting with Muammar el-Qaddafi<sup>775</sup> and inviting charges of anti-Semitism. Torrijos's entourage made the situation worse. He kept his controversial intelligence chief, Manuel Noriega, by his side. Torrijos's confidante and chief canal negotiator, Rómulo Escobar Bethancourt, the rector of the University of Panama, was a communist, and a rabidly anti-American sycophant.<sup>776</sup> In his memoirs, he called the Panama Canal Zone "unparalleled in the history of the iniquities of colonialism,"<sup>777</sup> and accused the United States of depriving Panama of the canal's economic advantages, though Panama had "lent her womb for the construction of this passage."<sup>778</sup> Torrijos's legal adviser for the canal negotiations, Adolfo Ahumada, was also a communist.<sup>779</sup> Sen. Helms summed up Torrijos's inner circle as "mercurial, Marxist, anti-American."

"Working with Torrijos required fancy footwork by the United States. His vanity and machismo had to be fed, his spending spree financed, his forays into international organizations parried and his constantly shifting image filtered for U.S. consumption. In the early 1970s, these tasks were simple enough, but by mid-decade, they had become a full-scale campaign of damage control."<sup>780</sup>

Torrijos's goal was to constantly pressure the United States to focus on the canal negotiations. But he was clearly wary of provoking too strong a response from Washington. For example, for his controversial Cuba trip, Torrijos sent Nicolás Ardito

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governments uninterested in an alliance with either the United States or the Soviet Union. Spearheaded by the leaders of Yugoslavia (Josip Broz Tito), Egypt (Gamal Abdel Nasser), India (Jawaharlal Nehru), Ghana (Kwame Nkrumah) and Indonesia (Sukarno), it has in some ways been superseded by the Group of 77 (G-77), a club of developing countries formed in 1964 that remains active at the United Nations General Assembly.

<sup>774</sup> Greene 1984, p. 38.

<sup>775</sup> Jorden 1984, p. 365.

<sup>776</sup> Ibid., p. 267.

<sup>777</sup> Rómulo Escobar Bethancourt, *Torrijos: Colonia Americana, No!* (Panama City, Panama: C. Valencia Editores, 1981), p. 250.

<sup>778</sup> Ibid., p. 259.

<sup>779</sup> Jorden 1984, p. 270.

<sup>780</sup> Coniff 1992, p. 128.

Barletta, his U.S.-educated minister of economic planning, to Havana as part of the delegation, and also dispatched representatives of the Panamanian private sector. Still, Torrijos's bombastic and confrontational style, not to mention his heavy drinking, eroded confidence in Panama's ability to manage the canal. Despite Panama's size, Torrijos was oddly (or perhaps brilliantly) convinced he could intimidate the United States through the combination of threatened violence and international opprobrium.<sup>781</sup> Through the years, he and his allies consistently deployed that tactic to pressure the United States to advance negotiations<sup>782783784</sup>:

1. On April 15, 1974, in a meeting with Vice President Gerald Ford at the Old Executive Office Building, the Panamanian foreign minister said, "I believe that for the United States, the best security for the canal is to have friends on both sides of it."<sup>785</sup>
2. To motivate Lewis, Panama's ambassador to the United States, to take a hard line in the canal negotiations, Torrijos once said, "the Panamanian people are a great ocean and the canal is a fish. *The ocean can live without the fish, but the fish can't live without the ocean*" (emphasis added).<sup>786</sup>
3. When negotiations with Panama floundered, U.S. Ambassador to Panama William Jorden warned that the U.S. Embassy would have to "batten down the hatches, fasten the seatbelts and stay away from outside windows"<sup>787</sup>; indeed, in September 1975, Panamanian protestors hurled rocks, bricks, bottles and Molotov cocktails at the embassy.<sup>788</sup>

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<sup>781</sup> Omar Torrijos, *Nuestra Revolución* (Panama City, Panama: Government of Panama, 1974), p. 142.

<sup>782</sup> Bethancourt 1981, p. 261.

<sup>783</sup> Rómulo Escobar Bethancourt, *Torrijos, Espada y Pensamiento* (Panama City, Panama: Impresora de La Nación, 1982), p. 23.

<sup>784</sup> It is debatable whether Torrijos would have actually risked armed conflict with the United States, but he managed to convince Graham Greene he was not bluffing. Torrijos, Greene said, "seriously contemplated a possible armed struggle between his tiny country and the great power which occupied the zone." In an early conversation on Contadora Island, Torrijos told Green, "If the students break into the zone again, I have only the alternative of crushing them or leading them. I will not crush them." Torrijos, Greene wrote, daydreamed about launching a guerrilla war against U.S. forces that would have put U.S. civilians on the front line for the first time since the Civil War. (For his part, Greene daydreamed of a Panamanian coin honoring Torrijos.)

<sup>785</sup> Jorden 1984, p. 245.

<sup>786</sup> Ibid., p. 404.

<sup>787</sup> Ibid., p. 285.

<sup>788</sup> Ibid., p. 298.

4. “Patience has its limits,” Torrijos once said. “We are now following the peaceful route of Ghandi. We are also prepared to follow the Ho Chi Minh route if necessary.”<sup>789</sup>
5. Later, bombs exploded in the Panama Canal Zone, including three in a 48-hour period.

Torrijos’s international allies tried a similar approach. Referencing the Panama Canal Zone, the Soviet leader, Nikita Khrushchev (1953 to 1964), warned the United States to “get out before you are tossed out.”<sup>790</sup>

Amid all of Torrijos’s tough talk and amateurish behavior, the U.S. government got serious about the canal negotiations again. It was not, however, out of any newfound confidence in Panama’s managerial knowhow or a belief that Panama could eventually master canal administration. Rather, several factors had collectively reduced the perceived importance of the canal to the United States:

1. Following World War Two – when more than 10,000 U.S. military vessels had crossed the canal, including 17 battleships and 29 aircraft carriers<sup>791</sup> – the United States abandoned its plan for a one ocean Navy, investing in separate Atlantic and Pacific fleets that would not rely upon the canal. The United States also began constructing ships, beginning with the Forrestal-class aircraft carrier in 1952, that were too large for the canal locks;<sup>792</sup>
2. The United States did not want its nuclear submarines to transit the locks, which requires surfacing;
3. The U.S. interstate highway system made transatlantic ground transportation cheaper;
4. Economic and population growth on the West Coast increased demand for West Coast products, reducing coast-to-coast commerce;<sup>793</sup>
5. Successive increases in U.S. foreign aid to Panama, designed to placate the restive Panamanian public, had made operating the canal increasingly costly, and justifiable only on the grounds that Panama could not be trusted to take the reins;

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<sup>789</sup> Kitchel 1978, p. 29.

<sup>790</sup> Ibid., p. 60.

<sup>791</sup> Mauer 2010, p. 218.

<sup>792</sup> Ibid., p. 224.

<sup>793</sup> Ibid., p. 212.

6. Railroad costs were dropping in the United States, increasing competition for the canal;<sup>794</sup> and,
7. Post-Panamax ships – commercial vessels too large for the canal locks – were emerging from shipyards.

In this context, President Richard Nixon (1969 to 1974), a Republican, decided to address the canal issue, a “time bomb” he had inherited from Johnson. Nixon, who feared potential sabotage of the canal by terrorists, appointed a respected, retired diplomat, Ellsworth Bunker, as his canal negotiator, following Bunker’s six-year assignment as the U.S. ambassador to South Vietnam. (Bunker was familiar with Panama from his participation in the diplomatic negotiations following the 1964 flag riots,<sup>795</sup> when he served as the U.S. ambassador to the Organization of American States.) In October 1970, Nixon met Panamanian President Demeterio Lakas – a friend of Torrijos who was known as “Jimmy” and kept a Thomson submachine gun at his bedside<sup>796</sup> – in the Rose Garden and echoed Johnson’s commitment to a new canal arrangement. At Nixon’s urging, negotiations resumed in earnest. At the time, Panama shared U.S. concerns over Panama’s ability to run the canal; the country lacked specialists qualified for an array of technical tasks, including pilots, hydraulic engineers and dredging experts. In the talks, Panama quickly accepted a phased ownership transition designed to prevent “chaos,” in the words of Carlos López Guevara, a Panamanian negotiator whose sister, Flor, was married to Torrijos’s older brother, Moises.<sup>797</sup> The Bunker-led negotiations were generally cordial; the U.S. diplomat brought maple syrup from his Vermont farm for his

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<sup>794</sup> Ibid., p. 241.

<sup>795</sup> Furlong 1984, p. 66.

<sup>796</sup> Jorden 1984, p. 151.

<sup>797</sup> Ibid., p. 157.

Panamanian counterparts.<sup>798</sup> Still, the two sides were far apart on the length of the ownership transition, with the United States pushing for five more decades in charge, more than double the period Panama would accept.<sup>799</sup> As a result, Torrijos again turned to intimidation and international pressure. Inspired by the growing influence of the Organization of the Petroleum Exporting Countries,<sup>800</sup> Torrijos, in January 1972, sent Panamanian Foreign Minister Juan Antonio Tack and U.N. Ambassador Aquilino Boyd to Addis Ababa, Ethiopia, to condemn the United States before the UN Security Council. In his remarks, Boyd compared the U.S. presence in Panama to colonialism in Africa, and he warned that “the danger of a violent confrontation between Panamanians and North Americans grows every day.”<sup>801</sup> Boyd’s U.S. counterpart, George H. W. Bush, chided Panama for deviating from the meeting agenda, but Boyd was unbowed. “To condemn colonialism, any rostrum at any time is appropriate,” he said. Buoyed by Boyd’s star turn in Ethiopia, and a temporary seat on the UN Security Council, Panama convinced the UN Security Council to hold a meeting in Panama City the next year. The meeting lasted five days, beginning on March 15, 1973. Panama hosted it in its legislative palace, a block from the Panama Canal Zone, and across from an enormous banner that asked, “What country of the world can bear the humiliation of a foreign flag piercing its heart?”<sup>802</sup> This time around, it was Torrijos himself who addressed the UN Security Council on

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<sup>798</sup> Howard B. Schaffer, *Ellsworth Bunker: Global Troubleshooter, Vietnam Hawk* (Chapel Hill, N.C.: University of North Carolina Press, 2003), p. 276.

<sup>799</sup> *Ibid.*, p. 166.

<sup>800</sup> Iran, Iraq, Kuwait, Saudi Arabia and Venezuela established the Organization of the Petroleum Exporting Countries, known as OPEC, in 1960. It now also includes as members, in order of accession, Qatar, Indonesia, Libya, the United Arab Emirates, Algeria, Nigeria, Ecuador and Angola.

<sup>801</sup> Borders, William, “China and Soviet Support Militants at U.N. Session,” *The New York Times*, February 1, 1972.

<sup>802</sup> Jorden 1984, p. 190.

Panama's behalf. Earlier, hoping to make the United States "feel a sense of shame,"<sup>803</sup> Torrijos had traveled to Bogotá, Colombia and San José, Costa Rica seeking support from fellow heads of state.<sup>804</sup> Now, he turned to a broader audience, delivering half an hour of anti-American broadsides about the U.S. "colony in the heart of my country."<sup>805</sup> (On other occasions, he compared the Panama Canal Zone to apartheid.<sup>806</sup>) Panama, he said, refused to be "another star on the flag of the United States,"<sup>807</sup> and he urged the United States to make concessions or face "violent changes" to the status quo. He emphasized the unfairness of having a foreign power control Panama's most prized resource, which he compared to Chile's copper and Cuba's sugarcane.<sup>808</sup> Like Torrijos's speech, Panama's one-sided canal resolution offered little to appeal to U.S. sensibilities. Following fruitless negotiations, the United States vetoed the resolution,<sup>809</sup> despite a threat from Noriega, who had warned the U.S. UN ambassador, John A. Scali, "If you are going to veto the resolution, you better do it at the airport."<sup>810</sup> Diplomatically, it was still a win for Panama; its resolution attracted 13 votes in favor, and even the British elected

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<sup>803</sup> Severos, Richard, "U.N. Panel Sits in Panama Today," *The New York Times*, March 15, 1973.

<sup>804</sup> Jorden 1984, p. 178.

<sup>805</sup> Severos, Richard, "Panama's Chief Denounces U.S. and Warns of 'Violent Changes,'" *The New York Times*, March 16, 1973.

<sup>806</sup> Omar Torrijos, *La Quinta Frontera: Partes de la Batalla Diplomática sobre el Canal de Panamá* (San José, Costa Rica: Editorial Universitaria Centroamericana, 1978), p. 26.

<sup>807</sup> Torrijos liked that metaphor, which he used in his 1973 book, *La Batalla de Panamá* (Buenos Aires, Argentina: Editorial Universitaria de Buenos Aires).

<sup>808</sup> Paul B. Ryan, *The Panama Canal Controversy: U.S. Diplomacy and Defense Interests* (Washington, D.C.: Hoover Institution Press, 1977), p. 112.

<sup>809</sup> The UN Security Council has 15 voting members, including five permanent members – China, France, Russia, the United Kingdom and the United States – that have the right to veto a resolution. (Article 27 of the UN Charter provides that authority, noting that UN Security Council decisions require "the concurring votes of the permanent members," <http://www.un.org/en/sections/un-charter/chapter-v/index.html>.)

<sup>810</sup> Jorden 1984, p. 196.

to abstain rather than support the U.S. opposition.<sup>811</sup> It was only the third U.S. veto in UN history.<sup>812</sup> Nixon was not amused.

The diplomatic dispute left the two countries at loggerheads. Torrijos's strategy, however, was succeeding.<sup>813</sup> In the Cold War battle for the hearts and minds of the developing world – where poverty and inequality heightened the appeal of the Soviet Union – the U.S. Department of State saw the Panama Canal Zone as a liability. Thanks to Torrijos, it appeared that the United States was not a benefactor bringing modernity and wealth to a small, poor country, but instead a colonial bully abusing Panama's sovereignty and stifling its development. In September 1973, after the U.S. Senate confirmed Henry Kissinger as secretary of state, Kissinger instructed Nixon's new canal envoy, Bunker, aged 79, to move aggressively. Kissinger's push was bolstered by an increasing perception in the United States that the canal's strategic value had become a "myth, the product of nostalgia."<sup>814</sup> As discussed, the United States had long ago bit the bullet and invested in a two ocean navy.<sup>815</sup><sup>816</sup> Moreover, the canal itself was considered indefensible, vulnerable to both military assault and insurgent sabotage.<sup>817</sup> In addition to the drumbeat of threats from Panamanian officials, Kissinger himself warned of a

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<sup>811</sup> "The United States has vetoed Panama, but the world has vetoed the United States," Panamanian Foreign Minister Juan Antonio Tack said following the UN Security Council vote.

<sup>812</sup> Conniff 1992, p. 130.

<sup>813</sup> Adolfo Ahumada, *Omar Torrijos* (Panama City, Panama: Fundación Omar Torrijos, 2000), p. 32.

<sup>814</sup> *Ibid.*, p. 209.

<sup>815</sup> That investment, authorized by Congress in 1940, erased the benefit that had originally motivated Captain Alfred Mahan, and his admirer, Theodore Roosevelt, to support the canal's construction, as well as the related argument that the waterway provided the essential link between East Coast-based U.S. naval vessels and the new U.S. Pacific colonies of Hawaii and the Philippines.

<sup>816</sup> This was not a universally accepted position. After all, in the 1970s, most U.S. military vessels could still fit through the canal, and the waterway served as a key supply route during the Vietnam and Korean Wars.

<sup>817</sup> By one estimate, a guerrilla attack that breached the dam holding back Gatun Lake could shutter the canal for two years.

potential “Vietnam-type situation in Panama”<sup>818</sup> Presumably, Nixon thought those conditions had improved the political climate for a canal agreement. In Panama, too, there was impatience for renewed negotiations. The UN Security Council meeting, though a public relations coup, “also brought home to Torrijos the difference between a UN resolution and actual diplomatic progress.” Soon, Bunker was shuttling between Washington and Contadora Island, off of Panama’s Pacific coast, where he and Tack, the Panamanian foreign minister, hammered out the principles for a new canal treaty. On February 7, 1974, Kissinger and a handful of U.S. lawmakers flew from Andrews Air Force Base to Panama’s Tocumen International Airport to sign the agreement. The terms mirrored the stillborn proposals negotiated under the Johnson administration, but Torrijos still considered the agreement an historic achievement, and he personally greeted the U.S. delegation at Tocumen. Along the route to the legislative palace in Panama City, crowds of men, women and children gathered in front of tinroofed shacks to stare silently at Kissinger’s motorcade.<sup>819</sup> At the ceremony with Torrijos and Lakas, the audience gave Kissinger a standing ovation after he and Tack had initialed each page of the eight principles and listened as the agreements were read aloud. In his remarks, Kissinger explicitly noted that the agreement had initiated a process of “replacing an old treaty” – an effort the secretary of state had undertaken “in the president’s name” and with the intention “to complete the negotiation successfully and as quickly as possible.”<sup>820</sup>

Kissinger told Panamanians that the agreement on principles marked the start “of a new adventure.” He probably meant that optimistically. But Kissinger’s principles did

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<sup>818</sup> Jorden 1984, p. 296.

<sup>819</sup> Binder, David, “U.S. Agrees to Yield Sovereignty of Canal to Panama,” *The New York Times*, February 8, 1974.

<sup>820</sup> Jorden 1984, p. 222.



little to smooth negotiations. For one, elements in the United States – including the Pentagon, Congress and the public – continued to have deep misgivings about entrusting the canal to Panama. Rep. Murphy, a Pennsylvania Democrat and Marine Corps veteran,<sup>821</sup> reprimanded Kissinger for negotiating with Panama’s “unstable government.” Sen. Thurmond, a South Carolina Republican who participated in the invasion of Normandy, cautioned that Kissinger’s principles would “cause grave harm to the United States.”<sup>822</sup> Not only did opposition to the turnover persist in the United States, but Kissinger’s principles also failed to resolve differences between *pro*-treaty forces in Washington and Panama City. On Contadora Island, negotiators wrangled over the duration of the transition to Panamanian control; who would be responsible for defending the canal’s neutrality (the United States, say, or perhaps the United Nations); whether the U.S. government, in addition to increasing annual payments to Panama during the transition, would provide a lump sum, goodwill payment to Panama’s cash-strapped government<sup>823</sup> (at one meeting, at the Mayflower Hotel in Washington, Escobar demanded a \$1 billion payout,<sup>824</sup> an “almost fatal blow” to the negotiations<sup>825</sup> that prompted a panicked call from Carter to Torrijos<sup>826</sup>); and whether the United States would maintain a permanent military presence in the canal zone, and be permanently guaranteed expeditious passage through the canal for U.S. Navy vessels.

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<sup>821</sup> Biographical descriptions of U.S. lawmakers are primarily drawn from the Biographical Directory of the United States Congress, <http://bioguide.congress.gov/biosearch/biosearch.asp>.

<sup>822</sup> Jorden 1984, p. 241.

<sup>823</sup> Ultimately, the Panama Canal Treaty provided Panama, during the two-decade transition period, \$10 million a year for public services in the former Panama Canal Zone (such as police protection and firefighting); \$0.30 per ton of cargo transiting the zone (Article XIII, Section 4a) for use of Panama’s “natural resources”; a \$10 million annual annuity (Article XIII, Section 4b); and up-to \$10 million more annually if the canal generated sufficient profits (Article XIII, Section 4c).

<sup>824</sup> Jorden 1984, p. 394.

<sup>825</sup> Carter 1982, p. 158.

<sup>826</sup> Despite the martinis, Carter’s canal negotiator, Sol M. Linowitz, said the Mayflower Hotel meeting with Rómulo Escobar Bethancourt was a low point in the negotiations. “It was a bad lunch,” he said.

Despite these significant disagreements, the negotiations continued, uninterrupted even by Nixon's resignation on August 9, 1974 and his replacement by Vice President Ford (1974 to 1977).<sup>827</sup> Following Nixon's departure, Kissinger wrote to Tack, the Panamanian foreign minister, to assure him that Kissinger would remain in Foggy Bottom and that canal negotiations would continue.<sup>828</sup> He kept his word. In March 1975, in remarks in Houston, Texas, Kissinger began by acknowledging the concerns of treaty opponents: "We will expect Panama to understand our perspective that the efficient, fair and secure operation of the canal is a vital economic and security interest of the United States," he said. But Kissinger did not back down from the treaty negotiations, insisting that "a treaty negotiated in 1903 does not meet the requirements of 1975."<sup>829</sup> Later, in May 1975, Kissinger again spoke publicly about the canal negotiations, telling fellow foreign ministers at the Organization of American States that "the need for a new treaty is clear." Kissinger's treaty advocacy was remarkable, given the climate on Capitol Hill. A month after Kissinger's remarks to the Organization of American States, for example, Rep. Gene Snyder, a Republican from Louisville, Ky., argued unsuccessfully for a ban on any federal spending on canal negotiations – a concept supported by Sen. Harry Byrd, a Virginia independent. After all, the Panama Canal Zone, Snyder insisted, was "as legitimate as our owning New York City."<sup>830</sup> Torrijos did not help matters when he replaced Tack, his foreign minister, with Boyd, the firebrand who had relished berating the United States as Panama's UN ambassador.

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<sup>827</sup> While most observers consider the new Panama Canal treaties to be a Carter phenomenon, the negotiations actually occurred under *four* presidents, including Johnson, Nixon and Ford, as will be discussed in greater detail.

<sup>828</sup> Jorden 1984, p. 254.

<sup>829</sup> Ibid., p. 281.

<sup>830</sup> Ibid., p. 282.

## Carter's Sprint to a Deal

It would be naïve to argue that anyone could have bridged the divide over the proposed canal turnover. However, President Jimmy Carter (1977 to 1981) might have reassured nonpartisan treaty opponents had his negotiators focused far more on the governance issues that a Panamanian state-owned enterprise would face if Panama inherited the canal. True, as discussed, Carter's final canal treaties addressed the need to hire and train Panamanians during the transition to Panamanian canal ownership. Those requirements, and the multi-decade length of the transition, allayed some concerns about the turnover.<sup>831</sup> ("If you gave me 20 years, I could learn to be a pilot, and I'm not even a sailor," Rep. Yvonne Burke, a California Democrat and lawyer from Los Angeles, Calif., once said.<sup>832</sup>) Early on, Panamanian elites also recognized canal quality control as a "fundamental mission of the operation."<sup>833</sup> But in U.S. Ambassador William Jorden's painstaking account of the canal negotiations,<sup>834</sup> "Panama Odyssey," Carter's negotiators did not appear to address the future structure of Panama's canal authority; its independence from Panama's central government; and its means for warding off corruption and patronage. In fact, it appears that negotiators spent much more time designing the binational entity that would run the canal during the transition period than

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<sup>831</sup> Torrijos calculated that the transition would last 8,395 days. It is not clear how he arrived at that number. In all, 8,150 days passed between the treaty signing (September 7, 1977) and the canal turnover (December 31, 1999); 8,104 days between Panama's ratification of the treaty (October 23, 1977) and the turnover; 7,927 days between the U.S. Senate's ratification of the second of the two canal treaties (April 18, 1978) and the turnover; 7,868 days between the exchange of the instruments of ratification for the treaties (June 16, 1978) and the turnover; and 7,397 days between the day the treaties entered into force (October 1, 1979) and the turnover.

<sup>832</sup> Jorden 1984, p. 254.

<sup>833</sup> Nicolás Ardito Barletta, *Estrategia para el Desarrollo Nacional: Visión, Realización, Actualización* (Panama City, Panama: Universidad Latina de Panamá), p. 34.

<sup>834</sup> At 780 pages, Jorden's memoir is even longer than David McCullough's famed, and famously long-winded, account of the canal's construction (698 pages), "The Path Between the Seas: The Creation of the Panama Canal, 1870-1914."

in shaping the Panamanian organization that would be in charge indefinitely as of December 31, 1999. Meanwhile, what talk there was regarding state-owned enterprise management was “a political exercise far more than a discussion of administrative techniques and organization.”<sup>835</sup> Aristides Royo, a Panamanian canal negotiator and later Panama’s president (1978 to 1982), said U.S. negotiators never raised questions about Panama’s ability to manage the canal. “The U.S. negotiators were very respectful in that sense,” he said.<sup>836</sup> After U.S. Senator John Melcher, a Montana Democrat, worried aloud about Panama’s canal managerial skills, Linowitz, the U.S. canal negotiator, provided only a vague reassurance about a continuing U.S. “background role” following the proposed canal turnover.<sup>837</sup>

This important shortcoming was not for lack of focus on the canal issue. Carter, elected on November 2, 1976, had immediately identified Panama as a top foreign policy priority. The month after the election, the Commission on U.S.–Latin American Relations released a report recommending a new canal treaty, and Carter and his advisers embraced its conclusions. Torrijos’s threats to attack the canal had not endeared him to successive U.S. presidents, but the threats spooked U.S. officials, including at the Carter White House. Promoting the treaties in a speech on February 1, 1978, Carter said negotiations with Torrijos were a better idea than “sending our sons and grandsons to fight in the jungles of Panama.”<sup>838</sup> Senior officials feared mortars and sniper fire aimed at ships transiting the canal. Zbigniew Brzezinski, Carter’s national security adviser, even worried

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<sup>835</sup> Jorden 1984, p. 388.

<sup>836</sup> Interview by author with Aristides Royo, August 27, 2013.

<sup>837</sup> Linowitz 1985, p. 196.

<sup>838</sup> Carter’s phrasing suggests that he took the commission’s recommendations to heart. In its report, the commission had warned, “It is possible to conceive of a time when the United States might ultimately be required to defend its position in Panama by use of force in the midst of a hostile population and in the face of universal condemnation by the region and the world.”

that violence in the Panama Canal Zone could spread throughout Central America.<sup>839840</sup>

By contrast, Carter hoped new Panama Canal treaties would reduce anti-American sentiment regionally; stand globally “as a symbol of our understanding of the change in the Third World”<sup>841</sup>; deprive Panamanian communists of a rallying cry<sup>842</sup>; and help in the Cold War global public opinion battle by demonstrating that “America would no longer be seen as defending the status quo, nor could the Soviet Union continue to pose as the champion of greater equity.”<sup>843</sup> Carter later said he was also motivated by his belief that the 1904 canal treaty was an historical wrong that mortally damaged the United States-Panama relationship<sup>844</sup>: “I was convinced that we needed to correct an injustice. Our failure to take action after years of promises under five previous presidents had created something of a diplomatic cancer, which was poisoning our relationship with Panama.”<sup>845</sup> Carter dismissed Reagan’s anti-treaty arguments as simplistic and wrongheaded. The United States, Carter reasoned, had never really owned the canal anyway, as evidenced by the rent payments it had forked over all those years.

Carter’s secretary of state, Cyrus Vance, publicly committed to honoring past agreements with Panama. For his part, Carter, even before his swearing-in, insisted that the canal issue “ought to be resolved quite rapidly”<sup>846</sup> He wasted no time.

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<sup>839</sup> Brzezinski 1983, p. 51.

<sup>840</sup> In his memoir, Carter also alluded to threats to the canal. “Though we could not talk about it much in public, the canal was in serious danger from direct attack and sabotage unless a new and fair treaty arrangement could be forged,” he wrote. To protect the canal in these circumstances would have required 100,000 troops, Carter estimated.

<sup>841</sup> Brzezinski 1983, p. 54.

<sup>842</sup> Carter 1982, p. 156.

<sup>843</sup> Brzezinski 1983, p. 123.

<sup>844</sup> Carter 1982, p. 153.

<sup>845</sup> Ibid., p. 155.

<sup>846</sup> Jorden 1984, p. 341.

1. Carter's first foreign policy order, Presidential Review Memorandum 1, issued January 21, 1977, the day after his inauguration, requested an interagency analysis of the Panama Canal question.
2. To speed the canal negotiations, Carter hired Linowitz, who had authored the Commission on U.S.–Latin American Relations report, as Bunker's co-negotiator in the treaty talks.<sup>847</sup>
3. On January 31, 1977, Vance invited Boyd and Escobar to Washington to discuss the path forward<sup>848</sup> and afterward, Vance announced continued U.S. support for the Kissinger-Tact Agreement.<sup>849</sup>
4. On February 13, 1977, Bunker and Linowitz traveled to Panama to jumpstart the negotiations.<sup>850</sup>
5. On April 14, 1977, Carter addressed the Organization of American States, where he echoed Kissinger's reassurances regarding the canal negotiations and said he recognized "Panama's legitimate needs as a sovereign nation;"<sup>851</sup> the 1903 treaty, he said, was "no longer appropriate or effective."

Even under Carter, the negotiations were no cake walk. In his memoir, Linowitz describes the disappointments of his first trip to Panama. Torrijos had housed Linowitz on Contadora Island in Gabriel Lewis's beachfront hotel, with its ground floor casino and tennis courts, and set aside the first day of negotiations for "relaxation and recreation." In the initial discussions, Linowitz found the Panamanians mostly interested in arguing. Torrijos then suspended negotiations for the weekend; after the chief Panamanian negotiator, Rómulo Escobar Bethancourt, accompanied Torrijos to a carnival celebration in Colombia, Escobar missed the Monday negotiating session. "Rarely have I had such a discouraging experience," Linowitz wrote.<sup>852</sup>

Still, Carter's persistence got him his treaties, their final details hammered out in marathon sessions at the Holiday Inn in Punta Paitilla, a wealthy section of Panama City,

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<sup>847</sup> To avoid a Senate confirmation fistfight, Carter used a 180-day recess appointment for Linowitz, giving Linowitz only from February 12, 1977 to August 10, 1977 to complete the negotiations.

<sup>848</sup> Before long, Boyd resigned and Torrijos appointed Nicolás González-Revilla as foreign minister.

<sup>849</sup> Furlong 1984, p. 87.

<sup>850</sup> Jorden 1984, p. 357.

<sup>851</sup> Hovey, Graham, "President Supports Human Rights Stand In Speech to O.A.S.," *The New York Times*, April 15, 1977.

<sup>852</sup> Linowitz 1985, p. 156.

and in Washington, just hours before the signing ceremony at the Organization of American States. At the ceremony, attended by 18 heads of state from the region, “Carter literally glowed.”<sup>853</sup> The deal, Carter argued, had converted Panama from an embittered bystander into the canal’s most important stakeholder. Following the successful Holiday Inn negotiations, the U.S. negotiators had flown home on an Air Force plane, and Carter’s helicopter picked them up at Andrews Air Force Base and transported them to the White House, where Carter greeted them alongside 100 reporters and photographers.<sup>854</sup> Following the Organization of American States ceremony, Carter hosted a state dinner at the White House, where he included Muhammad Ali and Ted Turner among his guests.

However, as discussed, the terms of Carter’s final deal did not impress the anti-treaty crowd. While Torrijos celebrated the agreement by declaring a national holiday in Panama, Carter confronted a deeply suspicious U.S. Congress and public, whose unease over the canal’s future never fully subsided. On his way to the Organization of American States treaty signing, Linowitz passed protestors using a makeshift gallows to hang him in effigy.<sup>855</sup> The subsequent Senate debate over the treaties, Linowitz said, was “among the most emotional episodes in American politics in this generation.”<sup>856</sup>

### **Panama’s Political Hot Potato**

These tensions over the canal are more than an historical footnote. Congressional angst over the turnover was arguably the number-one reason the widespread belief that Panama would mismanage the canal crystallized in the United States. Opposition on

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<sup>853</sup> Brzezinski 1983, p. 137.

<sup>854</sup> Linowitz 1985, p. 176.

<sup>855</sup> Ibid., p. 178.

<sup>856</sup> Ibid.

Capitol Hill legitimized the vague unease of American voters and provided cover to nationalists, conspiracy theorists and jingoists who bemoaned any concessions to Panama. The symbolism of the canal as a monument to U.S. power and ingenuity<sup>857</sup> also helped Carter's opponents stoke public anger and insecurity.

Congressional opposition, as discussed, did not originate with Carter's treaties. Not at all. U.S. Rep. Daniel Flood, for example, had once demanded that Eisenhower be impeached for flying the Panamanian flag in the Panama Canal Zone.<sup>858</sup> True, anger over the treaties reached its zenith in 1977, with unprecedented, bipartisan fury directed at the Carter White House, fueling and fueled by the public uproar. But anti-treaty momentum on Capitol Hill had gained serious force years before, as Ford competed in the Republican presidential primary for a full term. In that race, Ford's fiercely anti-treaty challenger, Ronald Reagan, transformed the proposed canal turnover into "a symbol of American retreat and weakness."<sup>859</sup> Reagan portrayed the canal negotiations as secretive and irresponsible. Torrijos's government, he said in a fundraising letter, was "antagonistic and unstable."<sup>860</sup> For Reagan, the canal issue proved to be a dependable applause line, particularly in Florida and throughout the South, including during the North Carolina primary,<sup>861</sup> when crowds roared at Reagan's canal references.<sup>862</sup> The canal was even the subject of a Reagan TV advertisement. Reagan's attack on Ford's pro-negotiations position was sharp-edged: Ford was rewarding a "military dictator, Fidel

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<sup>857</sup> Alexander Missal, *Seaway to the Future: American Social Visions and the Construction of the Panama Canal* (Madison, Wis.: University of Wisconsin Press, 2008).

<sup>858</sup> Adam Clymer, *Drawing the Line at the Big Ditch: The Panama Canal Treaties and the Rise of the Right* (Lawrence, Kan.: University Press of Kansas, 2008), p. 10.

<sup>859</sup> Jorden 1984, p. 290.

<sup>860</sup> Clymer 2008, p. 21.

<sup>861</sup> Lyn Nofziger, *Nofziger* (Washington, D.C.: Regenery Gateway 1992), p. 181.

<sup>862</sup> Richard Wirthlin and Wynton C. Hall, *The Greatest Communicator: What Ronald Reagan Taught Me About Politics, Leadership and Life* (Hoboken, N.J.: John Wiley & Sons, 2004), p. 25. Reagan won the North Carolina primary by 10 percentage points, following five straight primary defeats.



Castro's good friend"<sup>863</sup> and succumbing to Panamanian blackmail.<sup>864865</sup> The canal, Reagan insisted, was "sovereign United States territory just as much as Alaska is, as well as the states carved from the Louisiana Purchase."<sup>866867868</sup> As Reagan put it, repeatedly, in his favorite formulation: "We built it, we paid for it, it's ours and we're going to keep it."

Ford regarded Reagan's canal commentary as "inflammatory and irresponsible," and unlikely to sway Republican primary voters. "I felt the voters were smart enough to realize that his verbal swipes were the final lunges of a desperate man," Ford wrote in his memoirs.<sup>869870</sup> Indeed, Reagan's canal rhetoric was not only overheated, but also misleading. For example, the U.S. government had long acknowledged Panama's titular sovereignty over the Panama Canal Zone; it acted like it, too, paying annual rent to Panama, for example, and denying automatic U.S. citizenship to babies born in the zone unless they had a U.S. citizen parent. As a result, not everyone bought Reagan's canal arguments, including some members of his own party. U.S. Sen. Barry Goldwater, an

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<sup>863</sup> Though Torrijos's association with Castro damaged Torrijos's standing in the United States, Carter saw Torrijos as a centrist whose failure to secure a canal treaty could have encouraged the emergence of radical leftists in Panama.

<sup>864</sup> Wirthlin 2004, p. 26.

<sup>865</sup> The blackmail theme was common among opponents of the canal turnover. Campaigning in Florida, Reagan said, "our State Department apparently believes the hints regularly dispensed by the leftist Torrijos regime that the canal will be sabotaged if we don't hand it over. Our government has maintained a mouselike silence as criticism of the giveaway has increased. I don't understand how the State Department can suggest we pay blackmail to this dictator, for blackmail is what it is." Other critics echoed the blackmail theme. At one point, Carter's adversaries mailed pennies to U.S. senators in reference to a slogan from the days of the Barbary pirates, "millions for defense, not one cent for tribute." Rep. Flood once derided an agreement related to Panamanian flags in the canal zone as "another Munich."

<sup>866</sup> Wirthlin 2004, p. 29.

<sup>867</sup> A retired Panama Canal Zone judge, Guthrie Crowe, one-upped Reagan, telling his audience at an anti-treaty rally that the canal zone was as American as "Manhattan, Alaska or Texas."

<sup>868</sup> U.S. Secretary of State William H. Seward negotiated the purchase of Alaska from Russia for \$7.2 million in 1867, an acquisition critics called "Seward's Folly" at the time. It attained statehood in 1959. The United States purchased Louisiana from Napoleonic France in 1803 for \$27 million.

<sup>869</sup> Gerald R. Ford, *A Time to Heal: The Autobiography of Gerald R. Ford* (New York City, N.Y.: Harper & Row, 1979), p. 374.

<sup>870</sup> Opposition also came from *within* the Ford Administration. Like Rep. Flood, Defense Secretary James R. Schlesinger seemed to consider the negotiations a form of appeasement. "When the United States shows strength and determination, it receives respect. When it recedes from its position, it whets appetites," Schlesinger said. In White House meetings, Schlesinger, a hardline opponent of the turnover, clashed with Kissinger over the duration of the canal transition period, according to Kissinger's memoirs.

Arizona Republican, cautioned that Reagan's rhetoric risked provoking a war with Panama. Goldwater said he supported the canal turnover, "and I think Reagan would too if he knew more about it."<sup>871</sup> Ultimately, Reagan's strategy was unsuccessful in the Republican primary. Nevertheless, Reagan's further politicization of the canal issue helped set the stage for a later mobilization of voters against the turnover, with public anger channeled into a blizzard of angry letters and postcards addressed to senators. In Congress and on the campaign trail, denigrating the canal treaties – and often the entirety of Panama – was a winning formula. U.S. Sen. Bob Dole, a Kansas Republican and Ford's running mate in 1976, attacked the treaties as he eyed his own presidential run,<sup>872</sup> reveling in allegations that Torrijos's brother, Moises, Panama's ambassador to Spain, was a drugrunner. Even Carter, in a presidential debate with Ford on October 6, 1976, said he would "not relinquish practical control of the Panama Canal Zone anytime in the foreseeable future,"<sup>873</sup> contradicting promises made by U.S. negotiators since the days of Nixon.

The canal treaties were also an ideological battleground. That colored the U.S. view of Panama and the expectations of Panama's management of the canal enterprise. The geographic terms of the canal debate in the United States strayed from Central America to broad discussions of the U.S. role in the world.<sup>874</sup> The writer Isaac Don Levine, for example, argued that U.S. canal policy should reflect the aggressive Brezhnev Doctrine and the threat of a "communist tide lapping the shores of the Caribbean."<sup>875</sup>

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<sup>871</sup> Jorden 1984, p. 320.

<sup>872</sup> Ibid., p. 490.

<sup>873</sup> Ibid., p. 328.

<sup>874</sup> Hogan 1986, p. 4.

<sup>875</sup> Isaac Don Levine, *Hands off the Panama Canal* (Washington, D.C.: Monticello Books, 1976), p. 90. Levine pooh-poohed the threat of a Panamanian attack on the canal in comparison to the Soviet threat to the Western Hemisphere: "The promoters of the new Panama Canal treaty have raised the bugaboo of

New Hampshire Governor Meldrum Thompson also framed the issue in Cold War terms: Carter faced a choice to either “stand brave and firm for freedom in this real world of spreading Communism,” or “crawl into historical obscurity in the face of the hysterical howling of world opinion.”<sup>876</sup> Many critics of the turnover spoke of U.S. canal construction as a pharaonic project, the moonshot of the early 20th century, that had become an “emblem of American glory.”<sup>877</sup> In that framing, the proposed U.S. exit from Panama would inevitably signal American decline and retreat.

Chafing at the ideological undertones of the canal debate, Carter complained of a smear campaign by “archconservative groups.”<sup>878</sup> Chief among those groups was the American Conservative Union, led by Rep. Crane, who mixed passion with academic gravitas. (He taught history at Indiana University, where he had earned his PhD in 1963.) Crane not only published a full-length book opposing the turnover – “Surrender in Panama: The Case Against the Treaty” – but also aired the first political infomercial in U.S. history, a half-hour program on the canal shown 209 times around the country.<sup>879</sup> His organization – backed by other Tea Party precursors<sup>880</sup> in what was then known as the “New Right” – had help from an estimated 100,000 supporters<sup>881</sup> and instigated one of the heaviest letter writing campaigns in congressional history.<sup>882</sup> A fellow traveler,

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sabotage and violent outbreaks by Cuban-backed Panamanians if the United States fails to surrender control of the strategic waterway. Compare the risk of such attacks to the risk of the enemy moving into the heart of the Western Hemisphere, establishing his hegemony over the ebullient Latin American continent, with the inevitable consequence of a war of nuclear annihilation.”

<sup>876</sup> David Skidmore, “Foreign Policy Interest Groups and Presidential Power: Jimmy Carter and the Battle over Ratification of the Panama Canal Treaties,” *Presidential Studies Quarterly* Vol. 23, No. 3 (1993): 482.

<sup>877</sup> Major 1993, p. 333.

<sup>878</sup> Carter 1982, p. 160.

<sup>879</sup> Crane, Philip M., “Former Illinois Congressman and Conservative Leader Dies at 84,” *The New York Times*, November 20, 2014.

<sup>880</sup> Hendrik Hertzberg, “A Man, a Plan, a Canal: Bob Pastor (1947-2014),” *The New Yorker*, January 16, 2014.

<sup>881</sup> Conniff 1992, p. 135.

<sup>882</sup> Furlong 1984, p. 1.

conservative activist Richard Viguerie, compiled voluminous mailing lists of contributors to the anti-treaty cause, lists that later helped Reagan raise millions of dollars for his 1980 presidential campaign.<sup>883</sup> In all, 20 anti-treaty organizations joined together in two umbrella groups, the Committee to Save the Panama Canal and the Emergency Coalition to Save the Panama Canal.<sup>884</sup>

For his part, Carter mobilized a National Citizens Committee to support the treaties, and he deployed a “truth squad” that toured the country, sent millions of pro-treaty letters and raised millions of dollars.<sup>885</sup> Carter also sent his cabinet on a pro-treaty road show, gave dozens of speeches and interviews on the treaties, and held six town hall-style meetings on the issue.<sup>886</sup> By February 1978, the Carter Administration “blitzkrieg” had logged more than 800 speeches and interviews on the proposed canal turnover.<sup>887</sup> Carter even asked Bunker, the octogenarian treaty negotiator, to join the pro-treaty campaign, and sent him on trips to New Hampshire and Vermont, sometimes in the middle of New England blizzards.<sup>888</sup> At the White House, Carter aides briefed hundreds of opinion leaders they had flown in from around the country.<sup>889</sup> The challenge, as Kissinger told it, was that “most Americans don’t give a damn, a small minority is violently opposed to the agreement and no group is really for it.”<sup>890</sup> But that was not entirely true; Carter had support from the Committee of Americans for the Canal Treaties and from the religious and business communities. In general, however, the pro-treaty

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<sup>883</sup> Thomas M. Leonard, *Encyclopedia of U.S.-Latin American Relations* (Washington, D.C.: CQ Press 2012).

<sup>884</sup> Skidmore 1993, p. 480.

<sup>885</sup> Hogan 1986, p. 7.

<sup>886</sup> Hogan 1986, p. 95.

<sup>887</sup> Ibid., p. 7.

<sup>888</sup> Schaffer 2003, p. 298.

<sup>889</sup> Skidmore 1993, p. 486.

<sup>890</sup> Kissinger 1999, p. 716.

crowd had smaller numbers and scant funding. In the business community, opinion was too mixed for an effective lobbying push.

Public and Congressional interest had been growing and growing, and rightly or wrongly, Panama did not stand up well under the scrutiny. By the time Carter had defeated Ford and took office, fears of Panamanian incompetence were widespread.<sup>891</sup> Opponents of the treaties, Carter said, “alleged that Torrijos was a drug lord and that the Panamanian people themselves could not be trusted to manage their own governmental affairs.” Senators, Carter complained, depicted Panamanians as “idlers, didn’t work hard, were not fit to be trusted.” One anti-treaty pamphlet warned the United States against relying upon “the pathetic rabble” of Panama’s National Guard to protect the canal, and described Torrijos’s military as loyal to whomever provided its “salaries and graft.”<sup>892</sup> Carter knew better, having known Panamanians at the Georgia Institute of Technology, where he studied engineering. “I never doubted the fact that Panamanians could operate the canal, from the top down,” he said. But three decades after the treaties, he acknowledges he failed to persuade most U.S. voters. “It’s still a very unpopular action in the United States,” he said. That enduring unpopularity stems in part from the exaggerated political importance the canal debate attained. “At the beginning of 1976, no more than a handful of citizens in any American community could have located the Panama Canal on a map. By the end of the summer, one would have thought that reaching a new relationship with the tiny country of Panama threatened the emasculation of the United States and the end of its position as a great power.”<sup>893</sup> From

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<sup>891</sup> Interview by author with Jimmy Carter, April 13, 2015.

<sup>892</sup> Clymer 2008, p. 58.

<sup>893</sup> Jorden 1984, p. 315.

February 1977 to January 1978, half the Senate visited Panama.<sup>894895</sup> The visits were nominally intended to increase the familiarity of lawmakers with the canal issue. But in many cases, the congressional delegations simply sought evidence to reinforce their biases and to antagonize Panamanians. In one notorious encounter, in August 1977, three influential senators – Thurmond, Helms and Orrin Hatch, a Utah Republican elected to the Senate the year before – traveled to Panama, met with President Lakas, secretly taped their conversation and promptly leaked the recording to the media.<sup>896</sup> Other congressional visits ended better for Carter and Panama. On November 9, 1977, Byrd, the Senate majority leader, arrived in Panama and tuned in to the Torrijos show; at the time, Torrijos was performing on the San Blas islands, where Byrd saw him get an earful from angry Kuna Indians.<sup>897</sup> Byrd later supported the treaties, as did the minority leader, U.S. Sen. Howard Baker, a Tennessee Republican (and later Reagan’s chief of staff), a position that imperiled Baker’s presidential aspirations. Baker visited Panama on January 3, 1978 for a four-day tour that included, as in Byrd’s adventure, a Torrijos field trip, this time to Colón.<sup>898</sup> Byrd left confident Panama was up to the job of running the canal. Torrijos, Carter said, “impressed the visitors with his calm strength, his eagerness to give unadorned facts, his limitless patience in the face of vituperative attacks leveled at him by some members of Congress, his promises to democratize Panama’s government and to

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<sup>894</sup> Ibid., p. 459.

<sup>895</sup> On the House side, lawmakers were so frustrated they could not vote on the canal treaties that they unsuccessfully petitioned the Supreme Court for a say in the matter. The House even held hearings on the treaties, with witnesses characterizing the agreements as “illegal, unpatriotic, a cowardly yielding to blackmail, a boon to communism and a threat to our nation’s security,” Carter wrote in his memoir.

<sup>896</sup> Jorden 1984, p. 463.

<sup>897</sup> Ibid., p. 485.

<sup>898</sup> Ibid., p. 491.

correct any violations of human rights and his obvious determination to have Panama and the United States work in harmony during the decades ahead.”<sup>899</sup>

Like Torrijos, Carter found that defending the treaties was a full-time job. For Carter, too, it involved a lot of congressional hand-holding. In all, Carter briefed hundreds of elected officials, as well as newspaper editors, college presidents, campaign contributors and other influential actors.<sup>900</sup> The president’s allies made more than 1,500 public appearances promoting the treaties.<sup>901</sup> Lewis, the Panamanian ambassador, was a regular in the Oval Office, and Carter and Torrijos exchanged “a constant stream of messages.”<sup>902</sup> At one point, Carter kept a notebook in his desk with details on how senators were leaning on the canal treaties.<sup>903</sup> In all his logrolling, he spoke to every senator about the canal at least once,<sup>904</sup> promising so many favors that one administration official told *The New York Times*, “I hope the Panamanians get as much out of these treaties as some senators.”<sup>905</sup> On March 13, 1978, Carter wrote in his diary, “It’s hard to concentrate on anything except Panama.”<sup>906</sup> The Panama issue, he said, “had almost everything else bogged down.”<sup>907</sup> Every night, Carter practiced Spanish by reading a Spanish-language bible with the first lady.<sup>908</sup> The president was so consumed by Panama that his White House reportedly deferred efforts to complete the normalization of U.S. relations with China, a process begun under Nixon. The negotiation with Congress,

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<sup>899</sup> Carter 1982, p. 164.

<sup>900</sup> *Ibid.*, p. 162.

<sup>901</sup> *Ibid.*, p. 164.

<sup>902</sup> *Ibid.*, p. 163.

<sup>903</sup> *Ibid.*, p. 164.

<sup>904</sup> *Ibid.*, p. 165.

<sup>905</sup> Linowitz 1985, p. 198.

<sup>906</sup> Carter 1982, p. 171.

<sup>907</sup> *Ibid.*, p. 176.

<sup>908</sup> Linowitz 1985, p. 152.

Carter wrote in his memoirs, was “the most difficult political battle I had ever faced.”<sup>909</sup>

In one briefing for senators, Brzezinski even assured skeptics that if the Panamanians shut down the canal for repairs, “we will move in and close down the Panamanian government for repairs.”<sup>910</sup>

On September 26, 1977, the Senate Foreign Relations Committee at last began the formal canal treaty hearings. In all, the committee hearings lasted three weeks and involved 79 witnesses.<sup>911</sup> The committee concluded on January 25, 1978 that the proposed treaties were in the U.S. interest. The full Senate remained to be convinced, however, so Carter pleaded with Torrijos to improve Panama’s image in the United States. Dutifully, Torrijos traveled to Washington, on October 13, 1977, and signed a three-paragraph joint statement that interpreted key aspects of the treaties (such as the meaning of the “expeditious passage” offered to U.S. Navy vessels transiting the canal). The two leaders issued the statement on October 14, 1977, and the Senate later added it to the treaties.<sup>912</sup> On February 8, 1978, the full Senate debate began, a drawn-out, ugly affair carried live on radio, including a Spanish broadcast in Panama. In all, four Senate committees and one subcommittee held hearings on the canal turnover (as did three House committees and a House subcommittee).<sup>913</sup> The debate lasted 38 days, a congressional marathon that “practically excluded consideration of any other policy problems or issues.”<sup>914</sup> Whereas the Carter canal negotiations had not dwelled on Panama’s management capabilities, senators latched on to that issue to torpedo the canal

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<sup>909</sup> Ibid., p. 152.

<sup>910</sup> Brzezinski 1983, p. 136.

<sup>911</sup> Jorden 1984, p. 468.

<sup>912</sup> Ibid., p. 509.

<sup>913</sup> Furlong 1984, p. 142.

<sup>914</sup> Ibid., p. 143.



treaties. U.S. Sen. Paul Laxalt, a Nevada Republican, warned that “Panama does not now have, and cannot have within the short period of time required, the skilled personnel to fill adequately the jobs”<sup>915</sup> at the canal. The Democratic U.S. Sen. Quentin Burdick, of North Dakota, focused on Panama’s potential inability to maintain the canal adequately.<sup>916</sup><sup>917</sup>

Carter was losing his patience. The Senate, which typically does not amend treaties, had opted for an article-by-article consideration this time around. On March 1, 1978, Carter wrote in his diary that the Senate debate was going on “ad infinitum.”<sup>918</sup> Public opinion was also uncooperative; a classified account of Carter’s October 14, 1977 meeting with Torrijos notes that White House mail was running 10 to 1 against the treaties.<sup>919</sup> The Senate, however, eventually approved the first of the two canal treaties – the Neutrality Treaty, addressing canal security – by a vote of 68 to 32. The White House staff toasted the narrow victory with white wine and beer. Next, the Senate approved the Panama Canal Treaty – detailing the timeline and transition process for the canal transfer – by the same vote, 68 to 32, seven months after the Senate Foreign Relations Committee had begun its canal hearings. In all, senators had filed 105 amendments, 40 reservations<sup>920</sup> and 30 understandings.<sup>921</sup> It was arguably the most intense treaty debate since President Woodrow Wilson (1913 to 1921) unsuccessfully sought ratification of the

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<sup>915</sup> Ibid., p. 521.

<sup>916</sup> Carter 1982, p. 165.

<sup>917</sup> There is evidence that the U.S. treaty negotiators themselves shared this concern, though they did not focus on it in the treaty talks. Bunker, for example, once complained about a broken toilet on Contadora Island and joked, “If they can’t make my toilet flush, why should I think they could run the canal?”

<sup>918</sup> Carter 1982, p. 168.

<sup>919</sup> The memorandum is archived at the Jimmy Carter Presidential Library and Museum in Atlanta, Ga.

<sup>920</sup> Reservations and understandings stipulate conditions on treaties, or clarify the meaning of a section of a treaty, while not changing the treaty’s language, as occurs with an amendment.

<sup>921</sup> Jorden 1984, p. 565.

League of Nations.<sup>922</sup> The canal votes were so close – and unpredictable – that Brzezinski asked Robert A. Pastor, Carter’s top Latin America adviser, to draft a contingency statement demanding that the Senate reconsider the treaties, and ordered military contingency plans for a possible violent response by Panamanians.<sup>923</sup> For the same reason, the United States sent F-16s to Panama.<sup>924</sup> Carter listened to the Senate vote unfold with clenched fists;<sup>925</sup> “I had never been more tense in my life as we listened to each vote shouted out on the radio,” Carter recalled.<sup>926</sup> To say feelings were hurt by the vituperative canal debate does not do justice to the fallout from the treaty confirmation process. In Panama, Torrijos, who had been overjoyed by the treaty signings, told Panamanians in a speech that “never in our republic’s life has a Panamanian been more insulted than me.”<sup>927</sup> During the Senate debates, he became so infuriated he would smash his radio against the walls of his house.<sup>928</sup> Never before, he said, “has a country been subject to so much disrespect.” Torrijos still threw a party at his house after the final Senate vote, and fireworks lit up the Panama City sky. But in his official remarks, Torrijos spoke of his back-up plans for the evening. “Today,” he said, “the canal was placed within two votes of being destroyed.”<sup>929</sup>

Panamanians did not blame Carter for the invective of the Senate ratification debates. He was, and remains, a popular figure throughout Latin America. The memoir

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<sup>922</sup> Conniff 1992, p. 136.

<sup>923</sup> Brzezinski 1983, p. 138.

<sup>924</sup> Langer, Emily, “Robert Pastor, Panama Canal Negotiator, Dies at 66,” *The Washington Post*, January 11, 2014.

<sup>925</sup> Ibid.

<sup>926</sup> Carter 1982, p. 173.

<sup>927</sup> Jorden 1984, p. 623.

<sup>928</sup> Schaffer 2003, p. 300.

<sup>929</sup> Torrijos claimed that he had trained special National Guard units to incapacitate the canal, and deployed them the night of the Senate vote. He had even counted the likely dead, telling Panamanian lawmakers sometime later that armed conflict in the canal zone would have cost the lives of 50,000 Panamanians.

by Escobar, Torrijos's confidante, lauds the former U.S. president in a chapter titled, "Carter Takes the Bull by the Horns." The canal turnover "was a major success for the United States and for Panama," remarked I. Roberto Eisenmann Jr., the founder of *La Prensa*, a leading Panamanian newspaper, "a world power negotiating with a chicken shit country."<sup>930</sup> By contrast, in the United States, the hard-fought battle had damaged Carter politically, draining enormous political capital from the new president. Still, Carter opted for a victory lap. The U.S. Embassy in Panama City reserved the entire Holiday Inn to accommodate the foreign press corps for Carter's visit for the exchange of the instruments of ratification of the canal treaties.<sup>931</sup> Carter arrived on June 16, 1978, accompanied by Brzezinski, and sat on stage with Barletta and Escobar at the outdoor ceremony, where 50,000 Panamanians lined the streets to cheer.<sup>932</sup> Later, Carter and Torrijos shared a helicopter tour of the canal. In his journal, Brzezinski proudly mused, "we have set in motion a different pattern of relations with Latin America."<sup>933</sup>

### **Off the Rails**

The signing and ratification of the treaties removed Panama as a dinner table topic in the United States. That gave Panama breathing room to dive into the canal transition and gradually calm fears about the canal's still-distant future in Panamanian hands. In his inaugural address, on October 11, 1978, Panama's new president, former canal negotiator Aristides Royo, celebrated the canal treaties as Panama's "second independence." Later, in remarks to the Senate Foreign Relations Committee, Royo insisted Panama was up to the task of taking over the canal: "We recognize that with the fulfillment of those

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<sup>930</sup> Interview by author with I. Roberto Eisenmann Jr., Panama City, Panama, August 22, 2013.

<sup>931</sup> Jorden 1984, p. 638.

<sup>932</sup> *Ibid.*, p. 647.

<sup>933</sup> Brzezinski 1983, p. 139.

aspirations will come important responsibilities. We will now join the United States as a kind of trustee to the world.” Carter sent hand-written thank-you notes to all senators who had voted in favor of the canal treaties.<sup>934</sup> Vance, his secretary of state, cabled Royo to say he looked forward “to a close and creative relationship with your administration in the critical period that lies before us.”<sup>935</sup>

As discussed, however, Panama stumbled out of the gate. Though the United States still controlled the canal, it handed over much of the Panama Canal Zone on October 1, 1979, the day the treaties entered into force. Suffice it to say, U.S. observers were unimpressed with the new management. “The properties turned over to the Panamanian government declined precipitously.”<sup>936</sup> Panamanians looted furniture from reverted buildings, neglected the ports and let mosquitoes breed.<sup>937</sup> Car thefts skyrocketed. Squatters infiltrated U.S. military housing.<sup>938</sup> In other canal properties, palm trees grew inside buildings and poked out through shattered windows. The national port director stole a canal backhoe and brought it to his personal farm.<sup>939</sup> Soon, the former Panama Canal Zone streets were potholed and the airport runways covered in grass. Accidents became common at the ports.<sup>940</sup> At one port, all 102 forklifts turned over to Panama were inoperable 12 months later. Most tellingly, the historic Panama Canal Railroad stopped functioning entirely. Noriega had doubled its payroll to more than 300 employees, but the railroad had no schedule and nature had taken hold in its freight

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<sup>934</sup> Carter 1982, p. 152.

<sup>935</sup> The cable, dated October 11, 1978, is archived at the Jimmy Carter Presidential Library and Museum in Atlanta, Ga.

<sup>936</sup> Mauer 2010, p. 265.

<sup>937</sup> John P. Augelli, “The Panama Canal Treaties of 1977: Impact and Challenges,” *Conference of Latin Americanist Geographers* Vol. 11 (1985): 76.

<sup>938</sup> Robert R. McMillan, *Global Passage: Transformation of Panama and the Panama Canal* (Charleston, S.C.: BookSurge Publishing, 2009), p. 42.

<sup>939</sup> Interview with Dick Morgan, May 11, 2015.

<sup>940</sup> LeFeber 1989, p. 191.

cars.<sup>941</sup> Wooden ties burned after Panamanian landscapers could not control a fire set to control the grass. Rails disappeared as Panamanians stole the metal to build beach houses.<sup>942</sup> Eventually, the U.S. government prohibited U.S. personnel from riding the railroad, out of safety concerns.<sup>943</sup> “Within a matter of a few years, it was total junk. The Panamanians let it just fall apart completely,” Richard Wainio, who served as the director of executive planning for the U.S.-led Panama Canal Commission during the transition, said. “It sent a message to both sides,” Wainio added. “There was a huge concern on the part of the Americans when we saw everything fall apart.” That failure, he said, contributed to the belief that “maintenance is not in the Panamanian vocabulary.”<sup>944</sup> U.S. lawmakers also took note. In a hearing in 1988, Billy Tauzin, a Louisiana Democrat, expressed his concern “that having turned over the railroad and watched its lack of maintenance and operation, are we seeing or could we expect a similar occurrence in the canal?”

Panamanians were similarly appalled. Their government’s performance had confirmed their worst fears about the country’s weaknesses and inability to manage the canal. “It was a disaster,” Barletta, the former president, said.<sup>945</sup> Panamanians had gradually been gaining confidence since the early days of the canal negotiations, when even the U.S. Department of State warned against any changes to canal governance, and insisted “there was no mention of Panama taking on any operating responsibility, since nobody in Panama was thought to be suggesting that Panamanians were capable of

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<sup>941</sup> McMillan 2009, p. 43.

<sup>942</sup> “I was one of the ones who predicted disaster,” Dick Morgan, a former senior canal official, said. “The thugs who ran the government would steal from their own mothers.”

<sup>943</sup> Ana Elena Porras, *Historias Canaleras: Doce Testimonios de la Transición* (Panama City, Panama: Universidad de Panamá, Instituto de Estudios Nacionales, 2007), p. 111.

<sup>944</sup> Interview by author with Richard Wainio, September 2, 2014.

<sup>945</sup> Interview by author with Nicolás Ardito Barletta, August 27, 2013.

handling the complex canal mechanism.”<sup>946</sup> Under Noriega, however, all optimism was evaporating. It did not help that Panamanians, in the early years after the initial Panama Canal Zone land transfers, saw little development in the 364,000 acres of prime real estate, valued at \$5 billion.<sup>947</sup> “The administration of the railroad was a fiasco,” Felipe Joseph, a union leader, said. “We said, ‘Is that what we’re going to get’” when Panama takes over the canal?<sup>948</sup> Panamanians were also ashamed by the reverted areas, which were unkempt and decaying. “It was a mess,” Joseph said. “It was something tangible.” Tangible and foreboding. “The world doubted we’d succeed,” Elizardo Morales, a former president of canal employees association, said. “We even doubted it.”<sup>949</sup> Panamanians reacted with a renewed conviction to prepare for inheriting the canal. In other words, the collapse of the railroad made Panamanians raise their game. “The whole country saw the railroad go down the tubes, and saw the docks mismanaged,” Enrique E. Sánchez, the head of the canal’s purchasing division, said, provoking fear that “if we do to the canal what we did with those enterprises, we will never live that down.”<sup>950</sup> As Panamanians hatched a plan for their own canal authority, Sánchez said, the railroad and ports experience was fresh in their minds. “Everyone was really saddened by what happened with those two enterprises,” he said. “We failed so miserably,” he added, because “they made it part of the political spoils system.”

The railroad parallel was imperfect. The U.S. government, for example, had done little to prepare Panama to run the railroad, in contrast to its steadfast efforts to smooth the transfer of the canal. The railroad “was merely turned over to them lock, stock and

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<sup>946</sup> Major 1993, p. 336.

<sup>947</sup> Falcoff 1998, p. 100.

<sup>948</sup> Interview by author with Felipe Joseph, Panama City, Panama, August 22, 2013.

<sup>949</sup> Interview by author with Elizardo Morales, Panama City, Panama, January 18, 2013.

<sup>950</sup> Interview by author with Enrique E. Sánchez, Panama City, Panama, August 5, 2013.

barrel,” William R. Gianelli, chairman of the Panama Canal Commission, noted in congressional testimony at the time. Still, the decline of the railroad was a godsend for skeptics of Panama; the railroad was an historic, iconic operation, and its mismanagement no doubt drew attention to Panama’s future canal management responsibilities, including the job of operating the electric towing locomotives that run on cog tracks on the canal lock walls and pull large ships through the locks.

### **The Zonians**

In the United States, Panama’s stumbles in the former Panama Canal Zone were catnip to critics of the canal treaties. Zonians, in particular, trumpeted each and every misstep. The deterioration of former U.S. government properties in Panama provided limitless ammunition for Zonian fear mongering.

It is useful to pause a moment to consider the Zonians. The easily caricatured, often vilified, always ridiculed, Zonians. After all, their influence goes a long way toward explaining why so many observers in the United States were convinced Panama could not be trusted with the Panama Canal. Were the Zonians intrepid Americans serving their country in the wilds of primordial Panama? Or were they coddled, racist Americans addicted to government largess? Ultimately, what matters most are two indisputable Zonian qualities: in the debate over the Panama Canal’s future, the Zonians were deeply biased and uniquely influential. For a decade, the U.S. community in the Panama Canal Zone had been crusading against an end to the U.S. presence in Panama. Ford called Zonians “the most highly organized group of American employees I know.”<sup>951</sup> The appropriately named Rep. Flood, a mustachioed Pennsylvania Democrat who bitterly

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<sup>951</sup> Ibid., p. 258.

opposed the canal turnover, was known to House colleagues as “the congressman from the Canal Zone.”<sup>952</sup> By most accounts, Zonians were predisposed to harshly judge Panama’s performance. After all, the canal transfer threatened their livelihoods and their way of life. Their skepticism about Panamanians, however, was also generalized, long-held and deep-seated. In the canal’s early era, the Zonians had compared Colón and Panama City to Sodom and Gomorrah. Critics blamed them their attitude – “150 percent American and 50 percent whiskey”<sup>953</sup> – for provoking frequent clashes with Panamanian protestors. Decades later, during the canal treaty debate, the Zonians were still arguing that “the Panamanians were too backward to run the canal.”<sup>954</sup>

Relations between the U.S. Embassy in Panama City and the U.S. citizens in the Panama Canal Zone were always tense. To many U.S. nationals outside the Panama Canal Zone, the zone was an embarrassing outpost of backward “rednecks.” U.S. diplomats had even less patience for their fellow Americans during the delicate negotiations over the canal turnover. “There was a hard core of emotional, sometimes irrational, fanatics in the zone for whom any change would be for the worse,” Ambassador Jorden wrote in his memoir. “They did not know Panama, but they did not like Panama. They did not know Panamanians, but they were willing to write them off as incompetent and inefficient at best, if not violent Marxists. Many spoke no Spanish, rarely visited Panama, took their vacations in the United States and in general were about as parochial as a farmer from Montana or Mississippi who never went to the county

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<sup>952</sup> Jorden 1984, p. 99.

<sup>953</sup> Mary Knapp and Herbert Knapp, *Red, White and Blue Paradise: The American Canal Zone in Panama* (San Diego, Calif.: Harcourt 1984), p. 63.

<sup>954</sup> Clymer 2008, p. 4.



seat.”<sup>955</sup> (Zonians called the second set of locks on the canal’s Pacific side “Peter McGill,” instead of its Spanish name, Pedro Miguel.<sup>956</sup>) For Zonians, contact with Panamanians was not difficult; there were no physical barriers separating Panama from the Panama Canal Zone. Jorden suggested that Zonian mistrust of Panamanians reflected racist sentiments, and he compared a September 16, 1975 town hall-style meeting between Zonians in Balboa and the political counselor at the U.S. Embassy to a Ku Klux Klan rally.<sup>957</sup> Panamanians, as discussed, had even stronger feelings about their U.S. neighbors, whom Fernando Cardoze, a former member of the Panama Canal Commission board, likened to the French Pieds-Noirs in Algeria.<sup>958</sup><sup>959</sup> Greene described the Panama Canal Zone as a “world away from Panama,” where “you felt the jungle had been thrown back by a battalion of lawnmowers.”<sup>960</sup> Historians say Zonian social relations with Panamanians were limited – though that is in dispute – inhibited in part by limited interest among zonians for the Spanish language.<sup>961</sup> For Panamanians, the Zonian attitude, “an air of undisguised superiority,”<sup>962</sup> did not convey a warm welcome to Zonian life.

“The Americans who lived in the Panama Canal Zone... liked the status and privileges that came with residence in an area governed by the U.S. military and essentially barred to all Panamanians except those working for the United States. They had friends and relatives back home who were happy to help them protect their perquisites. And they had further help from millions of ordinary Americans whose history courses had proudly presented the construction of the Panama Canal as a great American accomplishment, in which Panama had merely

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<sup>955</sup> Jorden 1984, p. 301.

<sup>956</sup> Knapp 1984, p. 44.

<sup>957</sup> Jorden 1984, p. 303.

<sup>958</sup> Interview by author with Fernando Cardoze, Panama City, Panama, August 14, 2013.

<sup>959</sup> The pied-noirs (literally, “black feet”) were French colonialists in Algeria, which France controlled for 150 years until 1962, following an independence war that resulted in the deaths of an estimated 27,000 French troops and 6,000 French civilians and as many as 500,000 Algerians.

<sup>960</sup> Greene 1984, p. 49.

<sup>961</sup> Dimock 1934, p. 8.

<sup>962</sup> Falcoff 1998, p. 28.

provided the place where the ditch could be dug.... “The Americans who lived and worked in the Panama Canal Zone enjoyed, as the Panamanians said, all the benefits of colonialism. They had their own police and courts that applied American rather than Panamanian law, their own schools and hospitals, their own post office, subsidized shopping at military [commissaries], subsidized housing that was not especially lavish but was kept neat and clean and pleasantly landscaped by low-wage labor from across ‘the frontier.’ They were paid better than Panamanian workers who performed similar jobs, and they had the job security of American military employees..... Like most people with special privileges, they insisted that they were indispensable, that the Panamanians could never run ‘our’ canal.... They had come from all over the United States, and the rumors and suspicions they spread in their letters home helped rouse a domestic constituency against the treaties.”<sup>963</sup>

Not surprisingly, the Zonians saw themselves as patriots. Or at least, as normal public servants. Interested in their own self-interest? Sure. But also convinced they knew better than Washington policymakers about what was best for their Panama Canal. During the Carter years, there were 40,000 residents of the Panama Canal Zone: 25,000 military personnel and their dependents; 10,000 U.S. citizens employed by the Panama Canal Company and the Canal Zone government, and their dependents; and 5,000 Panamanian employees of the Panama Canal Company and the Canal Zone government, and their dependents. In the most detailed account of their lives, “Red, White and Blue Paradise: The American Canal Zone in Panama,” Mary and Herbert Knapp write warmly about their former friends and neighbors, and a utopian society that had vanished like Pompeii.<sup>964</sup> For the Knapps, the Panama Canal might have been a gift to global commerce, but the Panama Canal Zone was a workers’ paradise, “a star spangled, red, white and blue, post-capitalist society.”<sup>965</sup> That coziness helped attract U.S. workers to Panama. However, U.S. officials had other motivations for their Shangri-La striving in Panama. George Goethals, the legendary U.S. canal engineer, considered the zone

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<sup>963</sup> Linowitz 1985.

<sup>964</sup> The Knapps worked for 19 years as teachers in the Panama Canal Zone.

<sup>965</sup> Knapp 1984, p. 3.

evidence that “popular government, administered honestly and intelligently, is an agency for human welfare and happiness.”<sup>966</sup> The United States had a blank canvas for designing a model town: after signing the 1904 treaty with Panama, the U.S. government acquired all privately owned land in the Panama Canal Zone. The local newspaper – The Spillway – was a company newsletter, and the U.S. military operated the Panama Canal Zone radio and TV stations. In the early years, life in the zone was mostly a fight for survival, waged by adventurers in a daily “battle for bread”<sup>967</sup> and against fear. “There are three diseases on the isthmus: yellow fever, malaria and cold feet,” John Stevens, Goethals’s predecessor as chief canal engineer, once said.<sup>968</sup> The laborers digging the canal were no more spoiled than the mules and horses pulling the wagons, ambulances and fire trucks at the canal construction site. In the early years, half of all American canal workers returned home every year.<sup>969</sup> Granted, that was before the U.S. government set up bakeries with automatic pie, cake and bread machines; opened coffee roasting plants and ice cream factories; and produced its own mouthwash and shaving cream. Gradually, the engineers who controlled the Panama Canal Zone adopted a “spirit of paternalism, of modern socialism, of governmental parenthood.”<sup>970</sup> The government support including comfortable, though hardly extravagant, housing, typically in structures with a reinforced concrete exterior, clay tile roof and screened-in porch. Cradle-to-grave government services<sup>971</sup> were offered in an idyllic setting, the kind of verdant landscape that the John D. and Catherine T. MacArthur Foundation dreams of. There was “green jungle, green

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<sup>966</sup> Ibid., p. 4.

<sup>967</sup> Ibid., p. 17.

<sup>968</sup> Ibid., p. 19.

<sup>969</sup> Ibid., p. 26.

<sup>970</sup> Ibid., p. 31.

<sup>971</sup> William R. Scott, *The Americans in Panama* (New York City, N.Y.: Statler, 1912), p. 211.

lawns, green birds, green lizards,” and also “green mangos, green limes, green papayas.”<sup>972</sup> But it was still a jungle, always vaguely threatening. For neighbors, Zonians had mosquitoes carrying yellow fever, dengue fever and malaria, as well as snakes and tarantulas, iguanas, ñequi and ants. “Everything was faintly ominous,” the Knapps recalled. “Periodically, a platoon of grass-cutters appeared and fought back the jungle with mowers and machetes, but it was always there, just beyond the cleared area.”<sup>973</sup> Though often lumped together, the Knapps portray the inhabitants of this isolated U.S. terrain as a diverse bunch: bureaucrats on Ancón Hill, workers on the flats, the Atlantic siders, the Pacific siders, the dredgers in Gamboa, the Cuna Indians selling molas, their arms wrapped in tiny beads, the Chinese salesmen at roadside stands, and the Bajan-speaking Barbadians, who called an umbrella a “shower-stick,” “keep-dry” or a “house-in-hand.”<sup>974</sup> The Americans living in the zone – or “on the zone,” as they preferred to say – held different jobs and different world views. They were pilots, lockmasters, mull drivers, line handlers, cable splicers, translators, admeasures, marine traffic controllers, transit accounting technicians, divers, doctors, lawyers, merchant chiefs, butchers and bakers.<sup>975</sup> They were isolationists and nationalists, but also cross cultural and globalist. They had a Rotary Club and Lions Club, but welcomed Panamanian members. They had their own bowling alley, but invited Panama’s national symphony to perform in the Balboa High School gymnasium. They valued U.S. government hospitality, but also bought into the zone’s civil religion and its solemn rites, like moving a ship through the locks.<sup>976</sup>

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<sup>972</sup> Knapp 1984, p. 40.

<sup>973</sup> Ibid.

<sup>974</sup> Ibid., p. 49.

<sup>975</sup> Ibid., p. 76.

<sup>976</sup> Ibid., p. 93.

Carter's threat to the Zonian way of life was existential and not imaginary; the proposed treaties would turn their homeland into a "geographic ghost."<sup>977</sup> That lit a fire under Zonian activists. The Zonians, however, were not merely passionate, but also highly mobilized, creative, media savvy and well networked into the U.S. political system. To derail the canal negotiations, for example, one Zonian, a police officer named William Drummond, filed an unsuccessful federal lawsuit to enjoin the U.S. president from even speaking to Panama about a canal turnover. Zonians won support from the American Legion, the Veterans of Foreign Wars and the Daughters of the American Revolution.<sup>978</sup> In the Senate, Zonian ally Thurmond decried "the abandonment of U.S. citizens and employees in the Panama Canal area."<sup>979</sup> Later, after Carter completed the new canal treaties, 500 Zonians held a funeral procession, placing candles on the Goethals memorial.<sup>980</sup> In case Carter missed the point, Zonians prepared posters for the president's June 7, 1978 visit to the Panama Canal Zone that carried the slogan, "Re-elect Carter, the best president Panama ever had."<sup>981</sup>

So not surprisingly, during the political debate in the United States over the canal treaties, Zonians jumped on Panama's poor management of the reverted areas. After all, Panama's tomfoolery and administrative clumsiness not only reinforced their arguments, but also hurt their quality of life. Their evidence was compelling. "They were handed a gem" and destroyed much of their inherited infrastructure, Peter F. Romero, the U.S. assistant secretary of state for Western Hemisphere affairs at the time of the canal turnover, said. "It was a legitimate concern," he said, and instilled in U.S. lawmakers,

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<sup>977</sup> Ibid., p. 3.

<sup>978</sup> Kitchel 1978, p. 152.

<sup>979</sup> Linowitz 1985, p. 198.

<sup>980</sup> Jorden 1984., p. 654.

<sup>981</sup> Ibid., p. 654.

especially Republicans, “this incredible fear that the end of the world was coming.”<sup>982</sup>

The mismanagement of the former Panama Canal Zone properties, Romero said, exposed a worrisome vulnerability. “The Panamanians were notorious. It could have gone either way,” he said of the canal turnover. “The concern was the ineptitude of Panamanians.”

### **Banana Republic, Gone Bananas**

In the United States, the post-Torrijos political drama in Panama also reinforced the image of Panama as a basket case and laughingstock. It would be an understatement to say succession did not proceed smoothly following Torrijos’s 1981 plane crash. His successor atop the National Guard, Colonel Florenico Flores, was quickly pushed aside by General Rubén D. Paredes, who also forced out President Arístides Royo (1978 to 1982) in favor of Vice President Ricardo de la Espriella (1982 to 1984). (Royo said a sore throat had compelled his resignation.<sup>983</sup>) Soon afterward, in July 1983, Noriega seized control of the National Guard – later renamed the Panama Defense Forces – and forced out de la Espriella before the year’s end. The political tumult was embarrassing for Panama, but the United States put up with Noriega at first, in part because Noriega was supporting the U.S. fight against Nicaragua’s Sandinista government.<sup>984</sup> Starting in the mid-1980s, however, Noriega’s bullying and clumsy leadership truly became a black eye – and a troubling signpost for the future of the Panama Canal. In Panama’s 1984 presidential election, Noriega engineered a victory for Nicolás Ardito Barletta, a University of Chicago graduate and former World Bank vice president, in Barletta’s election against Arnulfo Arias. The election damaged Noriega’s international standing,

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<sup>982</sup> Interview by author with Peter F. Romero, Washington, D.C., July 10, 2014.

<sup>983</sup> Peter M. Sánchez, *Panama Lost? U.S. Hegemony, Democracy and the Canal* (Gainesville, Fla.: University Press of Florida, 2007), p. 159.

<sup>984</sup> Sánchez 2007, p. 162.

though admiration in the United States for Barletta, and distaste for Arias, limited the diplomatic fallout. (In addition to his impressive credentials, Barletta had played a helpful role in the negotiations of the new canal treaties.)

Panama's international profile, however, changed dramatically after Noriega ordered Barletta's removal after only a year in office. Noriega was reacting to Barletta's call for an investigation by Attorney General Manuel José Calvo of Noriega's role in the assassination of Hugo Spadafora, a former Torrijos cabinet member turned government critic whose decapitated body was discovered on September 14, 1985, stuffed in a U.S. government mailbag in Costa Rica, by the Panamanian border. By then, it was easy to turn against Noriega, the illegitimate son of his father's maid and a longtime employee of Colombia's Medellín drug cartel.<sup>985</sup> U.S. officials found him arrogant and obnoxious.<sup>986</sup> In his memoir, former U.S. Secretary of State George P. Shultz recalled Noriega as a hard drinker who would disappear unexpectedly at critical moments.<sup>987</sup> As smalltime villains go, Noriega was straight out of central casting. Senior U.S. diplomat Lawrence Eagleburger once mocked Noriega's attitude and avarice by cataloging Noriega's private boats: "Macho 1," "Macho 2" and "Macho 3." "That's *mucho* macho," Eagleburger said.<sup>988</sup> The U.S. position on Panama began to harden in 1988, after Miami and Tampa grand juries indicted Noriega on drug charges. Noriega was so mistrusted that Reagan's national security adviser, Colin Powell, warned that the United States might not comply

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<sup>985</sup> Leonard 1993, p. 97.

<sup>986</sup> Tom Wicker, *George Herbert Walker Bush* (New York City, N.Y.: Lipper/Viking, 2004), p. 141.

<sup>987</sup> George P. Shultz, *Turmoil and Triumph: My Years as Secretary of State* (New York City, N.Y., Scribner's, 1993), p. 1065.

<sup>988</sup> Juan B. Sosa, *In Defiance* (Washington, D.C.: The Francis Press, 1999), p. 245.

with the Panama Canal treaties if Noriega remained in power.<sup>989</sup> A CBS News/New York Times poll in May 1989 found that 26 percent of Americans agreed with Powell.

After Panamanian Vice President Eric Arturo Delvalle replaced Barletta, Noriega gradually lost the support of most U.S. and Panamanian elites.<sup>990</sup> Soon after Barletta had turned against Noriega, Torrijos's cousin, Roberto Díaz Herrera, also abandoned the regime, publicly accusing Noriega of involvement in the Spadafora murder and in drug trafficking.<sup>991</sup> On February 25, 1988, Delvalle attempted to fire Noriega, who in turn had Delvalle removed. Protests by the opposition National Civic Crusade, whose members waved white handkerchiefs at rallies, proliferated and anti-Noriega graffiti appeared throughout Panama City.<sup>992</sup> Noriega responded by deploying his "Dobermans," security forces wielding clubs, tear gas and guns who confronted protestors. At one point, Noriega ordered a raid on the University of Panama to repress students supporting a general strike.<sup>993</sup> At this point, the United States was supposed to be working hand-in-glove with Panama to prepare the ground for the canal turnover. Instead, the U.S. government began seizing Panamanian assets, adding an economic crisis to the country's political chaos. In 1988, Panama's economy contracted by 20 percent. In the May 7, 1989 presidential election, Noriega again intervened on behalf of his candidate, Carlos Duque, who was running against Arias ally Guillermo Endara. Pre-election polls gave Endara a two-to-one lead, and the Catholic Church's exit polls showed Endara with a three-to-one margin. Noriega's official tally, however, declared Duque the winner. In response to post-election unrest, Noriega's forces set upon protestors, beating Endara's running mate, Guillermo

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<sup>989</sup> LeFeber 1989, p. 214.

<sup>990</sup> Mauer 2010, p. 290.

<sup>991</sup> Ibid.

<sup>992</sup> Leonard 1993, p. 48.

<sup>993</sup> Sánchez 2007, p. 165.



“Billy” Ford, with crowbars and baseball bats, despite the presence of television cameras. Ultimately, Noriega threw out the election results, but in lieu of another election, he simply appointed a former high school classmate, Francisco Rodríguez, as president. The repression continued. On “Black Friday,” July 10, 1987, Noriega’s security forces arrested 600 demonstrators and injured 600 others.

For its part, the United States continued to recognize ousted President Delvalle, and Delvalle’s intrepid ambassador in the United States, Juan B. Sosa. That thrust Panama’s dirty laundry directly into the United States, and under the microscope of the U.S. media, Congress and public. Sosa, the former president of the American Chamber of Commerce in Panama, had strong ties to the U.S. government. Either way, the situation in Panama had become hard to ignore: Noriega was being represented in Washington by a diplomat whose priority was Noriega’s overthrow. As Sosa lobbied Reagan to freeze Panamanian assets in the United States – except for funds needed to keep the rouge embassy functioning – Noriega asked Interpol for Sosa’s arrest. Sosa refused to back down. On December 20, 1989, he got his wish of regime change, as 14,000 U.S. troops landed in Panama and began an assault on Noriega’s military headquarters, the Comandancia, in the heavily populated El Chorrillo district of Panama City, and at Panama’s main airports and military bases. The blitzkrieg invasion was a relatively straightforward affair. Still, it cost the United States 23 U.S. soldiers and three civilian personnel (an additional 323 U.S. military personnel were wounded) and \$163.6 million.<sup>994</sup> Meanwhile, Noriega continued to damage Panama’s reputation, even after his arrest: On April 10, 1992, he was convicted of eight criminal charges, and on July 10, 1992, he was sentenced to 40 years in prison.

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<sup>994</sup> Leonard 1993, p. 108.

## The Carter Effect

Panama's mismanagement of the reverted land and assets, and the Noriega contretemps, were not the only strikes against the canal treaties for many U.S. observers. The indelible association of the canal treaties with the Carter Administration also failed to instill confidence in the transition process. Carter was an unpopular president; he ended his first term with an average approval rating of just 45.5 percent, lower than any of the six presidents who preceded him or the five that have come after.<sup>995</sup> In the 1980 presidential election, Reagan routed Carter, winning 489 electoral votes compared to Carter's 49. The canal treaties appear to have contributed to that lopsided outcome,<sup>996</sup> but the reverberations moved in both directions; that is to say, Carter's unpopular, one-term presidency seems to have tarnished the idea of the canal turnover throughout the transition period. As discussed at length, the idea of a canal turnover, did not originate with Carter – a point Carter tried to convey by enlisting the Republicans Kissinger and Ford to lobby the Senate to pass the canal treaties.<sup>997</sup> (Both ultimately testified before the Senate Foreign Relations Committee.) In fact, the final language of the canal treaties mirrored the informal agreements reached by Johnson.<sup>998</sup> Under Nixon, a John Birch Society bumper sticker had read, "Don't give Panama our canal, give them Kissinger

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<sup>995</sup> Gallup Historical Statistics and Trends, "Presidential Approval Ratings,"

<http://www.gallup.com/poll/116677/presidential-approval-ratings-gallup-historical-statistics-trends.aspx>.

<sup>996</sup> Carter and the journalist Adam Clymer both attribute support for the canal turnover to a handful of electoral defeats in 1978, such as occurred with U.S. Sen. Richard Clarence Clark, an Iowa Democrat, whose opponents distributed bumper stickers urging voters, "Help us defeat Dick Clark before he votes to give away the United States." Two years later, opponents of U.S. Sen. Frank Church, who lost reelection in 1980, aired a TV advertisement exhorting voters to "remember the Panama Canal, built with American blood and treasure."

<sup>997</sup> In his testimony to the Senate Foreign Relations Committee, Secretary of State Cyrus Vance said, "The treaties are the culmination of 13 years work by four American presidents of both major political parties."

<sup>998</sup> Kissinger 1999, p. 767.

instead!”<sup>999</sup> Years later, Kissinger had not backed down. In a speech at New York University, he warned that Senate rejection of the treaties “would suggest to friends and foes around the world that the United States could not deliver on an agreement negotiated by four presidents of both political parties over a period of 13 years.”<sup>1000</sup> But in the public imagination, the canal turnover was and remains a Carter phenomenon.

Carter regarded the canal as the disgraceful detritus of American expansionism. But for Americans of a certain age, the loss of the canal continued to sting. For many in the United States, the waterway symbolized U.S. ingenuity,<sup>1001</sup><sup>1002</sup> not imperialism, and U.S. global dominance, or at least preeminence in the U.S. “backyard.” The loss of the canal, by contrast, gave the same sinking feeling experienced by Britons as their empire fell apart.<sup>1003</sup> The sensation was particularly acute given the U.S. defeat in the Vietnam War.

In December 1999, President Bill Clinton (1993 to 2001) and Vice President Al Gore declined to participate in the historic canal turnover ceremony. Gore, who was preparing a presidential run, had a reasonable excuse. But not even Secretary of State Madeleine Albright agreed to attend, though she had developed arguments in favor of the canal treaties as a legislative assistant to U.S. Sen. Edmund Muskie,<sup>1004</sup> a Republican from Maine; served in the Carter White House on the National Security Council; and

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<sup>999</sup> Clymer 2008, p. 18.

<sup>1000</sup> Henry Kissinger, *For the Record: Selected Statements, 1977-1980* (Boston, Mass.: Little, Brown, 1981).

<sup>1001</sup> William Mark Habeeb and I. William Zartman, *The Panama Canal Negotiations* (Baltimore, Md.: The Johns Hopkins Foreign Policy Institute, 1986), p. 5.

<sup>1002</sup> President Theodore Roosevelt cultivated that image of the canal even before it opened. In 1906, he spent three days touring the waterway, the first overseas trip by a U.S. president, and he lionized the U.S. engineers and laborers on the isthmus.

<sup>1003</sup> Luis Herrera, *The Panama Canal: An Exercise in International Relations* (Tampere, Finland: Tampere Peace Research Institute, 1978), p. 31.

<sup>1004</sup> Madeleine Albright and Bill Woodward, *Madam Secretary* (New York City, N.Y.: Miramax Books, 2003), p. 73.

while teaching at Georgetown University, had assigned her students a role-playing exercise negotiating the Panama Canal treaties.<sup>1005</sup> In the end, Carter led the 29-member U.S. delegation.<sup>1006</sup> As Time Magazine reported at the time: “Hey, Jimmy Carter made this deal, let him take the heat.”<sup>1007</sup>

Carter seems to have accepted, or perhaps even encouraged, his reputation as the solitary driver of the canal turnover. His presidential museum, on a 35-acre campus 1.5 miles east of downtown Atlanta, Ga., lends substantial real estate to Panama: one display lists the canal turnover number six on a list of 17 “notable achievements”; another shows a letter from Thurmond raising money for activists opposing the treaties (“There is no Panama Canal! There is an American canal at Panama.”); there are multiple photos of Torrijos, including one taken at the Organization of American States treaty signing ceremony and another – a life-sized banner – that shows Carter standing beside the general; and there is a photo of Carter and the first lady in Panama in April 1978 touring the canal. The museum section on Carter’s post-presidency notes that the Carter Center’s first election monitoring activities were in Panama, in 1989.<sup>1008</sup> Indeed, the Carter Center, and Carter himself, have stayed closely involved in Panamanian affairs; the Carter Center also monitored Panama’s 1994 election; participated in Panama’s post-election national dialogues; and later monitored Panama’s 2014 election. The Carter Center’s Council of Presidents and Prime Ministers of the Americas – tasked with promoting democracy,

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<sup>1005</sup> Ibid., p. 100.

<sup>1006</sup> Carter was joined at the Miraflores locks ceremony by King Juan Carlos I of Spain; President Miguel Ángel Rodríguez of Costa Rica; President Andrés Pastrana of Colombia; President Ernesto Zedillo Ponce de León of Mexico; President Jamil Mahuad of Ecuador; President Hugo Bánzer of Bolivia; and President Carlos Flores of Honduras.

<sup>1007</sup> Tony Karon, “Al Gore Keeps the President Away From Panama,” *Time*, December 14, 1999.

<sup>1008</sup> That experience might very well have been Carter’s most eventful election monitoring. In Panama City, the former president held a news conference to denounce Noriega’s electoral fraud, leading Noriega to expel the election monitors.

resolving regional conflicts, monitoring elections and fighting corruption – has included at least two former Panamanian presidents, Ernesto Pérez Balladares and Barletta. In 1995, Panama awarded Carter its highest honor, the Cross of the Order of Vasco Núñez de Balboa.

## Woops

The average U.S. voter could be forgiven for misjudging Panama's capacity to run the canal. In the United States, any number of common cognitive biases were probably at play, such as anchoring bias (overreliance on the first piece of information consumed, in this case a negative portrayal of Panama); the bandwagon effect; confirmation bias; conservatism bias (the preference for older evidence over newer data); and stereotyping (in this case, of Latin Americans). Even inside the Carter White House, not everyone apparently thought Panama was ready for prime time. In one classified memorandum, a White House official scrutinized the agenda for an upcoming visit to Panama, noting wryly, "The thought of moving by Panamanian helicopter does not inspire me."<sup>1009</sup><sup>1010</sup>

In the global shipping industry, there was also unease. Samuel Lewis Navarro, Panama's former vice president and foreign minister, traveled to Japan, South Korea, the Philippines and Taiwan as a member of the canal transition commission to learn about past governance transitions. Anxiety prevailed. "Shipping lines were constantly looking

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<sup>1009</sup> The memorandum, by Denis Cliff, is dated September 13, 1979, days before the treaties entered into force, on October 1, 1979. It is archived at the Jimmy Carter Presidential Library and Museum in Atlanta, Ga.

<sup>1010</sup> Panama's perceived backwardness is a constant theme among anyone who touched the canal debate. Graham Green, who so admired Torrijos, had an air of British superiority when it came to Torrijos's homeland. Good meals were rare, Green observed, and Panama's elite class was underpopulated. "Nobody in Panama City only turns up once. Like a play with a small cast, the same actors were always reappearing in different roles."

for alternatives,” he said.<sup>1011</sup> A 1978 book, “The Truth about the Panama Canal,” warned ominously that Panama, a “mere fledgling”<sup>1012</sup> of mostly “impenetrable jungle,”<sup>1013</sup> was “seeking to assume vast responsibilities, in fact to take the place of the United States, in a unique enterprise that is of great importance to the entire world and of particular importance to the United States.”<sup>1014</sup> It added: “Is Panama capable of fulfilling these responsibilities? This is the \$64,000 question.”<sup>1015</sup> The book was categorical in its criticisms – one chapter was titled, “No Job for Amateurs” – and detailed Panama’s supposed weaknesses in dredging, maintenance (“She creaks in spots. She tends to fall apart in places. It takes a sizable team of ‘doctors,’ a team of experienced, imaginative, devoted managers, engineers and mechanics, to keep her operating”) and operational skill to deal with the canal’s twisting shape, challenging currents, winds and fog.

Running the canal, an “elderly, fragile and unpredictable prima donna,” is “not that simple. Far from it. There are a thousand and one things that go on behind the scenes, day and night, to produce this appearance of simplicity. Things that require special skills, special knowhow, special equipment, special effort – even special loyalty and special dedication.... The canal is not just a complex of engineering and machinery. The canal does not run by itself. It is run by conscientious, experienced human beings, and the role these people play in its operation becomes increasingly greater as the canal grows older and as more and more ships that nudge the maximum dimensions for canal transit are designed and built. These two factors, canal age and ship size, combine to place an ever higher premium on skillful, experienced management, maintenance, traffic control and ship handling.”<sup>1016</sup>

Though Reagan largely dropped the canal issue during his presidency, conservatives never warmed to the turnover. In August 1999, three months before the canal handover, U.S. Senate Majority Leader Trent Lott, a Mississippi Republican,

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<sup>1011</sup> Interview by author with Samuel Lewis Navarro, Panama City, Panama, August 21, 2013.

<sup>1012</sup> Kitchel 1978, p. 111.

<sup>1013</sup> Ibid., p. 112.

<sup>1014</sup> Ibid., p. 111.

<sup>1015</sup> Ibid.

<sup>1016</sup> Kitchel 1978.

complained that the United States had “given the farm away without a shot being fired.”<sup>1017</sup> In 2000, John F. McManus, president of The John Birch Society, delivered an ominous hourlong presentation on the canal turnover. He summed up prevailing conservative views of the canal treaties: a “monumental mistake,” “a blunder of immense proportions,” “prime evidence of stupidity at the highest levels of governance,” a “betrayal of American interests” and a “travesty.” (The John Birch Society’s view was distinct, though no less critical; McManus called the turnover a conspiracy designed to bring about global governance by a totalitarian UN, and he flogged for House Resolution 77, calling on President Clinton to trash the Carter-Torrijos treaties.<sup>1018</sup> “The Panama Canal must be reclaimed,” McManus said.)

At the canal turnover ceremony, Robert R. McMillan, the former Panama Canal Commission chairman, felt certain Panama had the technical wherewithal to run the canal. He remained, however, “apprehensive about how efficiently Panama would run the canal,” because it was still unclear “whether the politics of Panama might interfere with canal operations and maintenance.”<sup>1019</sup>

As discussed, Panamanians had their doubts, too. Eduardo Antonio Quirós, the president of two leading Panamanian newspapers, *El Siglo* and *La Estrella*, and a former canal board member, compared Panama’s success running the canal to a rambunctious,

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<sup>1017</sup> Tim McGirk, “Giving Up the Ship? The Looming Handover of the Panama Canal has Fired Some Serious Separation Anxiety in the U.S.” *Time*, September 6, 1999.

<sup>1018</sup> The resolution, sponsored by Rep. Helen P. Chenoweth-Hage, an Idaho Republican, criticized Clinton for advancing the canal turnover “in defiance of both law and the national security and economic interests of the United States.” Thirty eight cosponsors supported the effort to nullify the 1977 Carter-Torrijos treaties.

<sup>1019</sup> McMillan 2009.

inattentive student who pulls off a high score on the final exam. “The way Panama has managed the canal is a surprise,” he said.<sup>1020</sup>

Still, close observers of the canal turnover process should surely have known better. At least by 1999. Conservatives might have portrayed Panama as an “unstable, ill-prepared country.”<sup>1021</sup> But there were other voices, such as supporters from business groups, including the U.S. Chamber of Commerce and the Council of the Americas. In an article entered into the congressional record during the canal treaties debate, Abraham F. Lowenthal and Milton Charlton argued that the criticism about Panama’s managerial capabilities “substitutes prejudice for prudential judgment.” There was no reason, they wrote, “to think that Panamanians are any less capable than Egyptians of learning how to manage complex operations. Whatever competence they lack now will probably be acquired before the proposed new treaty expires two decades from now. If not, Panama, like other countries, would be able to hire the required expertise.”<sup>1022</sup> Moreover, it was not as if the United States was the very model of a modern canal administration, contrary to the idealized view of the Panama Canal Zone advanced by partisans.<sup>1023</sup> “There is significant evidence that the United States managed the canal particularly poorly during the postwar period.”<sup>1024</sup> U.S. canal authorities never established an incentive structure for canal managers; afforded military officers an outsized managerial role; and permitted Zonians to ward off private sector-style reforms. In 1947, U.S. government inspectors

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<sup>1020</sup> Interview by author with Eduardo Antonio Quirós, Panama City, Panama, August 8, 2013.

<sup>1021</sup> K. Larry Storrs, “Major U.S. Foreign and Defense Policy Issues,” Congressional Research Service, January 1, 1977.

<sup>1022</sup> Not surprisingly, there were academics on the other side of the debate as well. Donald Marquand Dozer, a Latin American history professor at the University of California, Santa Barbara, opposed the canal turnover entirely because of concerns over Panama’s supposed incapacity to manage the waterway.

<sup>1023</sup> Rep. Philip Crane had insisted that the U.S. canal administration was a “model of efficiency, fairness and integrity.”

<sup>1024</sup> Mauer 2010, p. 248.



described the U.S. canal administration as “a museum of administrative antiquities.”<sup>1025</sup>

The U.S. Army long dominated the canal. The dimensions of the original lock chambers were determined by the size of U.S. battleships, and when the canal opened, it was run by a general, usually from the Army Corps of Engineers. These were not expert businessmen. The canal ran its first deficit in 1973 (\$1.3 million), and by 1974, the deficit had increased to \$11.9 million. As far back as the 1930s, outsiders thought the canal needed new blood. “Tropical climates are enervating,” one observer reported.<sup>1026</sup> “Government work, like the business of any large-scale organization, is likely to result in... red tape and lack of initiative. This natural tendency is strengthened in the enervating climate of Panama. After a few years, mental curiosity is diminished, and in most cases an all-consuming complacency gets into the very blood.”

For all their flaws, the canal treaties had explicitly addressed fears of exorbitant toll hikes, one of the major and enduring preoccupations of Carter’s critics. The Neutrality Treaty states: “Tolls and other charges for transit and ancillary services shall be just, reasonable, equitable and consistent with the principles of international law.”<sup>1027</sup> In terms of fears of Panama’s administrative skills, “the timing and transition mechanism were important,” Christopher L. Koch, the president of the World Shipping Council, said. “You had people from Panama who were engaged in the management and operation of the canal. You weren’t handing this over to a bunch of newbies.” (Koch added: “Did people raise questions? Yes. In hindsight, were they overblown? Yes.”) Pastor, Carter’s top Latin America adviser and a major driver of the treaties, said there was little cause for concern regarding Panamanian canal ownership. “We managed it like a socialist

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<sup>1025</sup> John Major, *The Cambridge History of Latin America*.

<sup>1026</sup> Dimock 1934, p. 166.

<sup>1027</sup> Article III, Section 1(c).

enterprise,” he said. “For some reason, we think the market works everywhere but Panama.” Pastor said Panama’s performance validated his confidence. “In every parameter, the Panamanians have done better than us,” he said.<sup>1028</sup> In fact, the U.S. performance in Panama was in some ways even worse during the canal transition – a period of supercharged U.S. skepticism of Panama – when the new, congressionally mandated management structure resulted in an even “less businesslike” canal operation.<sup>1029</sup>

To dispassionate observers, it should have been clear that many of the anti-treaty arguments were unrelated to the future health of the canal. Rep. Crane’s writings are a perfect example. It would be a “criminal blunder” to hand over the canal, he argued, the “cowardly retreat of a tired, toothless paper tiger” and “one more nail in the coffin of American sea power.” Perhaps. Perhaps it was “one more crucial American step in a descent to ignominy.” But those warnings should not have left the impression that Panama could not open and close the canal locks. During the canal debates in the 1970s, business groups had debunked the arguments that the proposed canal turnover would increase inflation, disrupt trade and increase unemployment. Even Reagan, after finally winning the presidency, stopped bringing up the canal issue. “It’s telling that Reagan, once he was president, did nothing to revoke or to alter the treaties. No more was heard of the economic and national-security horrors he had predicted as a candidate.”<sup>1030</sup>

Panama’s canal negotiators had shared Pastor’s confidence. Royo said: “There were some senators and journalists who prior to the Senate debates raised concerns over how turning over the canal to a small country could affect the infrastructure the United

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<sup>1028</sup> Interview by author with Robert A. Pastor, July 10, 2014. Pastor died on January 8, 2014.

<sup>1029</sup> Furlong 1984, p. 202.

<sup>1030</sup> Hertzberg 2014.

States had built there. Torrijos address this various times with visiting senators, noting that the canal was completed in 1914 with a system of locks in use since ancient times. How would it be possible that people at the end of the Twentieth Century could not manage infrastructure from the beginning of the century?” Carlos Ernesto González de la Lastra, of the Asociación Panameña de Ejecutivos de Empresa, agreed. “The Panama Canal is not a complicated operation; in reality, it is a river with a system of elevators for boats, its technology is basically from early last century, and it isn’t complicated,”<sup>1031</sup> he said. “There should have been no fear that Panamanians could not operate a river.”

In fact, despite Panama’s railroad and ports fiasco, the U.S. Government Accountability Office gave Panama high scores in the early years of treaty implementation, finding “no apparent degradation of service or major negative impacts.”<sup>1032</sup> The railroad itself was aged at the time of the transfer, and the ports were unprepared for the containerization revolution in global shipping. Ten percent of the 1,424 buildings the United States gave Panama were more than 70 years old, and another 15 percent were more than 60 years old.<sup>1033</sup> As the imminent canal turnover revived the debate in the United States over the canal issue,<sup>1034</sup> the influential newspaper columnist Andres Oppenheimer toured the former Panama Canal Zone in 1999 and found the concerns about Panama exaggerated. It was not Switzerland, he said, but it was in fine shape.<sup>1035</sup> Perhaps most surprisingly – and most importantly for the canal’s future and an objective analysis of the canal’s prospects under Panamanian control – Panamanian

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<sup>1031</sup> Porras 207, p. 184.

<sup>1032</sup> Furlong 1984, p. 182.

<sup>1033</sup> Omar Jaén Suárez, *Diez Años de Administración Panameña del Canal* (Panama City, Panama: Panama Canal Authority, 2010), p. 61.

<sup>1034</sup> Robbins, Carla Anne, “Changing Channels: Should U.S. Even Care That It’s About to Lose The Panama Canal?” *The Wall Street Journal*, December 10, 1999.

<sup>1035</sup> Oppenheimer, Andrés, “Estados Unidos Está Preocupado por el Canal de Panamá,” *El informe Oppenheimer*, April 20, 1999.

democracy had become strongly institutionalized by the canal turnover. Since Noriega's removal, the country had carried out presidential elections in 1994 and 1999 that involved healthy competition, high levels of participation and the peaceful transfer of power between parties.

## **Chapter 6: Conclusion: Forecasting risks to the Panama Canal's future success, and extracting lessons from its past performance**

### **Introduction**

The Panama Canal Authority could still stumble. Just as predictions of failure following the canal turnover proved misguided, it would be folly to forecast success going forward without at least a mention of risk factors. In other words, past performance is no guarantee of future results, as they say on Wall Street.<sup>1036</sup> Ironically, given the historical pessimism regarding Panama's canal management, it the canal's vulnerabilities that are now often overlooked.

These days, there is far less discussion of the canal's future than in previous eras. In the construction phase, in the early 20th century, the canal was the toast of the town. Later, the canal treaty negotiations, in the 1960s and 1970s, were a *bête noir* for U.S. conservatives. The rocky transition to Panamanian ownership kept international attention focused on the canal, especially after U.S. paratroopers invaded Panama to depose Manuel Noriega in 1989. By contrast, the era of Panamanian canal control has chugged along in relative obscurity. For journalists, it is the dog that didn't bite. Canal infrastructure never collapsed. Corruption never metastasized. Mismanagement never materialized. Even the canal's 100th anniversary, in 2014, was acknowledged primarily in Panama. This anonymity lends a sense of comfortable status quo to Panama's canal operation. A reassuring measure of positive momentum. The appearance of a virtuous circle, powered by deepening Panamanian expertise. Panama's mountain of impressive

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<sup>1036</sup> The phrasing comes from a disclosure to investors required by the U.S. Securities and Exchange Commission.

performance data triggered a tectonic shift in international opinion of Panama's canal authority.

Many of the biggest threats to the canal have become historical artifacts. The end of the Cold War eliminated the Soviet menace to the canal, and to its host nation. Similarly, the absence of major wars – armed conflicts involving global powers – greatly lowers the chances of a foreign military assault on the canal. Panamanian canal ownership means Panamanian security forces will not target the waterway, and gives Panama an incentive to prevent any assault.<sup>1037</sup>

### **External Vulnerabilities**

Still, it appears the pendulum may have swung too far when it comes to judging the Panama Canal's prospects. The list of threats to the canal is lengthy, and growing. Put another way, if Panama Canal Authority stock were traded on the New York Stock Exchange, its risk factor disclosures would spook cautious investors. For starters, a variety of external factors still greatly influence the canal's success. Global economic misfortune reduces international trade, which eats away at the Panama Canal's bottom line. The 2008 global economic meltdown offers a cautionary tale. The United States, by far the canal's biggest user,<sup>1038</sup> saw its over all goods exports plummet from \$1.29 trillion in 2008 to \$1.06 trillion in 2009, an 18 percent decline.<sup>1039</sup> U.S. imports saw an even steeper contraction, dropping from \$2.10 trillion in 2008 to \$1.56 trillion in 2009, a 26 percent decline. The impacts of the global financial crisis also hit other canal users; in all,

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<sup>1037</sup> Terrorism, however, remains a threat. Every year, the U.S. Southern Command, formerly based in the Panama Canal Zone, holds the "PANAMAX" joint training exercise to rehearse the defense of the canal by a multinational force. In 2015, 16 countries participated.

<sup>1038</sup> In fiscal year 2015, by tonnage, the United States was the top origin and destination of Panama Canal cargo, followed by China, Chile, Japan, Peru, South Korea, Colombia, Mexico, Ecuador and Canada, according to Panama Canal Authority data.

<sup>1039</sup> U.S. international trade data from the U.S. Census Bureau's Foreign Trade Division.

total global merchandise exports and imports fell 19 percent in first quarter of 2009 compared to the corresponding period in 2008.<sup>1040</sup> Consequently, total Panama Canal revenue declined in 2009 for the first time under Panamanian ownership, falling by 2.3 percent, to \$1.96 billion.<sup>1041</sup> That revenue decline would have been significantly worse if not for a 10.1 percent toll increase, phased in during May and October of 2009.<sup>1042</sup>

The canal also remains vulnerable to shifting trade patterns. On October 5, 2015, 11 Pacific Rim countries approved the Trans-Pacific Partnership free trade agreement.<sup>1043</sup> The pact could reshape maritime commerce, increasing trade between East Asia and countries on South America's Pacific coast, a route that does not cross the Panama Canal. That potential diversion of business is emblematic of a chronic, structural weakness at the waterway: The canal is simply insufficiently diversified, and bound by its geography. The United States still accounts for 70 percent of canal traffic, followed by China, the origin or destination of 23 percent of cargo. That could conceivably change with economic growth in South America, where only Chile (13 percent) and Colombia (9.6 percent) figure among the top five canal users. Peru, for example, relies upon the canal for 31 percent of its maritime trade, and its economy has been growing steadily in recent years. For the foreseeable future, however, Panama's fortunes will be linked to economic trends in the United States and China.

The canal is also threatened by increased competition. The reduction of Arctic ice brought about by climate change is creating a new, summertime shipping route that could

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<sup>1040</sup> Quarterly data on the volume growth rates of merchandise exports and imports from the United Nations Conference on Trade and Development.

<sup>1041</sup> Tonnage in 2009 fell by 3.5 percent, and Panama Canal profits decreased by 2.1 percent.

<sup>1042</sup> The 2009 toll increases were part of a three-year adjustment of tolls that included a 5.7 percent increase in 2007 and a 14.2 percent increase in 2008. Panama raised tolls eight times from 2000 to 2013.

<sup>1043</sup> In addition to the United States, the participating countries in the Trans-Pacific Partnership are Australia, Canada, Japan, Malaysia, Mexico, Peru, Vietnam, Chile, Brunei, Singapore and New Zealand.

eventually draw business away from the Panama Canal.<sup>1044</sup> A 2009 report by the Arctic Council, an intergovernmental forum,<sup>1045</sup> noted that “Arctic sea ice has been observed to be decreasing in extent and thickness during the second half of the 20th century and early 21st century.” Computer models, the council reported, predicted “a continuing retreat of sea ice” and raised the possibility of an ice-free Arctic Ocean in the summer months.<sup>1046</sup> The resulting Northern Sea Route begins at the Kara Strait in northern Russia, east of Finland, and stretches circuitously around Greenland and North America to the Bering Strait, between Russia and Alaska. The route, also known as the Northeast Passage, shaves between 35 to 60 percent off the distance between northern European ports and ports in East Asia, compared to trips through the Panama Canal or the Suez Canal. The journey is still treacherous; mariners face drifting icebergs even in the summer, and cargo ships are typically chaperoned by icebreakers. In bad news for Panama, however, the environmental trends highlighted in the 2009 Arctic Council report have continued. On February 25, 2015, scientists observed the lowest Arctic maximum extent (i.e., the ice coverage at the beginning of the sea ice melt season) in the satellite record,<sup>1047</sup> and saw downward trends in over all Arctic sea ice concentration<sup>1048</sup> and extent in all months.<sup>1049</sup>

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<sup>1044</sup> Kramer, Andrew E. and Andrew C. Revkin, “Arctic Shortcut Beckons Shippers as Ice Thaws,” *The New York Times*, September 10, 2009.

<sup>1045</sup> The Arctic Council is a forum designed to promote cooperation among Arctic states. Its members include the United States, Canada, Denmark, Finland, Iceland, Norway, Russia and Sweden.

<sup>1046</sup> The Arctic Marine Shipping Assessment 2009 Report is available on a National Oceanic and Atmospheric Administration Web site dedicated to Arctic issues, [http://www.arctic.noaa.gov/detect/documents/AMSA\\_2009\\_Report\\_2nd\\_print.pdf](http://www.arctic.noaa.gov/detect/documents/AMSA_2009_Report_2nd_print.pdf).

<sup>1047</sup> The data is provided by the National Snow and Ice Data Center, a federally funded program at the University of Colorado, Boulder.

<sup>1048</sup> Sea ice concentration is a unitless term that describes the relative amount of area covered by ice, compared to a reference area.

<sup>1049</sup> The 2015 maximum Arctic sea ice extent was 5.61 million square miles, 425,000 square miles below the 1981 to 2010 average of 6.04 million square miles. The 2015 maximum also occurred early; February 25 is 15 days earlier than the 1981 to 2010 average date of March 12.



A proposed canal across Nicaragua poses another threat to the Panama Canal. As discussed, the idea of a Nicaragua waterway was long considered an attractive alternative to a canal in Panama. In 1901, a commission set up by President William McKinley (1897 to 1901) to identify the “most practicable and feasible route” for a transisthmian canal concluded two years of scientific research.<sup>1050</sup> Its findings endorsed Nicaragua as the ideal canal site.<sup>1051</sup> Panama, of course, ultimately won the political debate in the U.S. Congress. However, a century later, in 2013, Wang Jing, a little known Chinese telecommunications tycoon, revived Nicaragua’s long deferred canal dream. He proposed a \$50 billion, 173-mile transoceanic waterway running through Lake Nicaragua, the largest lake in Central America. To many, Wang’s project has always seemed far-fetched. His proposed canal would be wider, deeper and three and a half times the length of the Panama Canal. Lake Nicaragua is 95 feet above sea level,<sup>1052</sup> and his proposed waterway would require an estimated 4.6 billion cubic meters of excavation.<sup>1053</sup> The Panama Canal Authority – hardly objective, but always analytical – is skeptical of Wang’s so-called Grand Nicaragua Canal.<sup>1054</sup> Given the scale of the project, “they’ll have a very difficult time to compete,” Jorge L. Quijano, the Panama Canal CEO, said. He estimated construction would actually cost \$70 billion. To be profitable, Nicaragua would have to charge double the Panama Canal tolls, a rate that would send ships fleeing around the Cape of Good Hope.

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<sup>1050</sup> David G. McCullough, *The Path between the Seas: The Creation of the Panama Canal, 1870-1914* (New York City, N.Y.: Simon and Schuster, 1977), p. 264.

<sup>1051</sup> An earlier report, by the Nicaragua Canal Commission, established by McKinley in 1897, had also favored Nicaragua over Panama.

<sup>1052</sup> Gatun Lake, in the Panama Canal, is 85 feet above sea level.

<sup>1053</sup> To put that in perspective, the French only managed to excavate 60 million cubic meters in 13 years of digging in Panama. The United States, after 10 years of digging in Panama, had only excavated 178 million cubic meters.

<sup>1054</sup> Jorge L. Quijano, presentation at the Center for Strategic and International Studies, Washington, D.C., May 20, 2015.

The Grand Nicaragua Canal has attracted fierce opposition locally, from both indigenous communities and conservationists in an uproar over a project they say would destroy or alter 1 million acres of rainforest and wetland, and foul Lake Nicaragua, the country's principle source of drinking water.<sup>1055</sup> Because Nicaragua's concession to Wang, published in English only,<sup>1056</sup> permits construction of an airport, two seaside ports, a railroad, an oil pipeline, a four-lane highway, hotels and free-trade zones, some say he hoodwinked Nicaragua and never actually planned to build the promised waterway. (Whatever his intentions at the outset, it appears unlikely Wang now has the financial wherewithal for the project; in 2015, a steep Chinese stock market decline reportedly deprived him of 85 percent of his \$10 billion fortune.) Skepticism about Wang's intentions is popular among those who deeply mistrust Nicaraguan President Daniel Ortega,<sup>1057</sup> a former Sandinista guerrilla. Ortega's formal announcement of the Grand Nicaragua Canal followed a long period of unfriendly speculation, with questions raised about the feasibility of the project, which has been described as "one of the region's biggest financial scams."<sup>1058</sup> Some even doubted Wang's existence. "Here is our brother Wang Jing," Ortega said at the canal announcement, dressed in a suede jacket and collarless white shirt. "Here is the phantom, in flesh and blood!"<sup>1059</sup>

Ortega might be something of a clown, but the Grand Nicaragua Canal is not wholly laughable. The proposed Nicaragua waterway would have distinct advantages

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<sup>1055</sup> Matthew Shaer, "A New Canal Through Central America Could Have Devastating Consequences," *Smithsonian Magazine*, December 2014.

<sup>1056</sup> Lakhani, Nina, "China's Nicaragua Canal Could Spark a New Central America Revolution," *The Daily Beast*, December 1, 2014.

<sup>1057</sup> The fine print of the deal raises questions about Nicaragua's negotiating abilities. For example, Wang agreed to pay Nicaragua \$10 million a year for 10 years, but the payments only begin if a canal is actually built.

<sup>1058</sup> Oppenheimer, Andrés, "Nicaragua's Transoceanic Environmental Scandal," *The Miami Herald*, November 26, 2014.

<sup>1059</sup> Jon Lee Anderson, "The Comandante's Canal," *The New Yorker*, March 10, 2014.

over its neighborhood rival, such as its proposed dimensions, large enough to accommodate supertankers too large even for the expanded Panama Canal to handle.<sup>1060</sup> (These ships, of mindboggling size, have been at sea since at least 2014 and include the Maersk Triple-E's,<sup>1061</sup> which carry more than 18,000 containers.<sup>1062</sup> Many liquefied natural gas carriers are also too large even for the expanded Panama Canal. Nicaragua says its canal would accommodate ships moving as many as 20,000 containers at a time and bulk carriers the length of 12 football fields.<sup>1063</sup>) Meanwhile, it is possible that Wang's HK Nicaragua Canal Development Investment Company is merely a stalking horse for the Chinese government, as many have suggested. In that case, astronomically high tolls would not be required to satisfy investors whose primary interest is a transoceanic waterway not dominated by the United States. That could yield costly competition driving down Panama Canal tolls. Questioned about the Grand Nicaragua Canal, Quijano once acknowledged that the Panama Canal might have to expand yet again in only 25 years.<sup>1064</sup> "We keep an eye on anything that could be competition," he said.<sup>1065</sup>

## Technological Edge

The Panama Canal is also subject to dramatic technological changes and global economic phenomena out of its control. Historically, technological advancement and

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<sup>1060</sup> Panama Canal officials downplay any limitations based on the size of the new locks, estimating that 98 percent of vessels would fit through the new lane.

<sup>1061</sup> Hakim, Danny, "Aboard a Cargo Colossus," *The New York Times*, October 3, 2014.

<sup>1062</sup> Each Triple E is large enough to transport 144 million pairs of sneakers. The downside: the 194-foot wide hull is wider than the 160-foot capacity of the new canal locks.

<sup>1063</sup> Johnson, Tim, "A Skeptical Panama Pays Heed to Possible Rival Nicaraguan Canal," *McClatchy*, February 9, 2015.

<sup>1064</sup> "Panama Canal to Get New Upgrade Within 25 Years," *Agence France-Presse*, September 23, 2014.

<sup>1065</sup> Former Panamanian President Martín Torrijos, in an interview by author, mentioned the arctic route.

long-term global economic transformations have been a boon for the Panama Canal. Globalization provided the strongest tailwinds. International trade exploded after World War Two, with global merchandise exports increasing by over 9 percent annually in real terms from 1950 to 1973.<sup>1066</sup> Oil shocks and inflation helped slow the growth in trade. But global export growth accelerated again in the 1990s, averaging 6 percent from 2000 to 2007, leading up to the 2008 global economic crisis. Similarly, containerization was a blessing for the canal business in Panama. Nowadays, this ubiquitous technique seems both obvious and timeless. But containerization is actually a fairly recent phenomenon. The transport of freight in large, uniform containers did not become common in ocean shipping until the 1960s, after shipyards began building vessels specially designed to carry containers, above and below deck.<sup>1067</sup> (Railroads relied upon a similar process decades earlier.) The method is particularly efficient because of the way ports have adapted to containerization, acquiring equipment including towering, 200-foot tall cranes that rapidly load and unload ships, trucks and railroads – all designed to carry standard, forty foot steel or aluminum boxes. As a result, the cost of shipping greatly declined, as shippers no longer relied upon “armies of ill-paid, ill-treated workers who once made their livings loading and unloading ships.”<sup>1068</sup> Poor countries, often distant from major global markets, could suddenly attract foreign manufacturers to set up shop and churn out clothes, shoes and electronics. In industrialized countries, manufactures increasingly

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<sup>1066</sup> Data from the World Trade Organization’s 2008 World Trade Report, an annual publication addressing trends in trade, trade policy issues and the multilateral trading system.

<sup>1067</sup> These container ships are utterly enormous, which helps explain the motivation behind the Panama Canal expansion. The ships carry as many as 20 containers side by side, stacked seven high on deck and eight deep below.

<sup>1068</sup> Marc Levinson, *The Box: How the Shipping Container Made the World Smaller and the World Economy Bigger* (Princeton, N.J.: Princeton University Press, 2008), p. 2.

discovered exporting. In both cases, much of the new maritime trading flowed through the Panama Canal.

The Panama Canal is also positioned to benefit from advances in horizontal drilling and hydraulic fracturing technologies that have given drillers access to the natural gas and oil in the vast U.S. shale formations. That technology propelled the United States to the number one spot on the list of global petroleum producers, ahead of Saudi Arabia and Russia,<sup>1069</sup> and to the top position among natural gas producers.<sup>1070</sup> The U.S. natural gas bonanza is particularly relevant to the Panama Canal. Whereas in an earlier era, U.S. Alaskan and California crude generated significant northbound traffic on the canal, now exporters along the U.S. Gulf Coast are poised to ship massive amounts of liquefied natural gas southbound through the canal to Asia. The U.S. Federal Energy Regulatory Commission has approved multiple liquefied natural gas export terminals, including Cheniere Energy's Sabine Pass liquefaction complex on the Louisiana coast. That \$12 billion facility is designed to chill natural gas to -260 Fahrenheit so it is transportable on tankers that will ply the newly expanded Panama Canal. In the case of the global energy market, volatility cuts both ways for Panama. Increasing global natural gas supplies are expected to slow investment in liquefaction projects in the United States. The plummeting price of energy will also hurt the Panama Canal; oil prices are below \$40 a barrel, down from \$126 in 2012, a 68 percent decline. Still, the five liquefied natural gas export terminals under construction in the United States, including Sabine

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<sup>1069</sup> In the U.S. Department of Energy's Energy Information Administration's 2014 ranking for petroleum and other liquids production, the top ten producers were the United States, Saudi Arabia, Russia, China, Canada, the United Arab Emirates, Iran, Iraq, Brazil and Mexico.

<sup>1070</sup> In the U.S. Department of Energy's Energy Information Administration's 2013 ranking for natural gas production, the top ten producers were the United States, Russia, Iran, Qatar, Canada, China, Norway, Saudi Arabia, the Netherlands and Algeria. In the United States, the unconventional gas revolution has raised estimates of natural gas resources to over 2,200 trillion cubic feet, a nearly 90-year supply.

Pass, likely have multiyear contracts in place with buyers, guaranteeing at least a medium term boost in Panama Canal activity.

### **Uncertain Future**

In general, however, technological change creates winners and losers. Just look at Eastman Kodak. In 1976, the company, founded in 1880, produced 90 percent of all film and 85 percent of all cameras sold in the United States.<sup>1071</sup> Eventually, digital cameras began eroding the sale of both film and film cameras. Kodak's revenue fell from \$16 billion in 1996 to \$2.5 billion three years later.<sup>1072</sup> At its 1,300-acre corporate campus in Rochester, N.Y., Kodak demolished 80 of its 200 buildings and sold another 59.<sup>1073</sup> Its payroll fell from 145,000 to 8,000.<sup>1074</sup> Digital technology is also no friend to the U.S. Postal Service. The widespread use of e-mail has helped reduce total mail volume from 211.7 billion in 2005 to 155.4 billion in 2014,<sup>1075</sup> a 27 percent decline. For U.S. newspapers, the advent of free online content – including from their own Web sites – has brought about relentless declines in circulation and revenue. Total daily circulation of U.S. newspapers fell from \$62 million in 1989 to \$40 million in 2014, a 35 percent drop.<sup>1076</sup> Total print ad revenue fell from \$45 billion in 2003 to \$16 billion in 2014,<sup>1077</sup> a 64 percent decline. The examples of Kodak, the U.S. Postal Service and newspapers are clearly unrelated to the maritime shipping business. But they illustrate the

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<sup>1071</sup> “The last Kodak moment?” *The Economist*, January 14, 2012.

<sup>1072</sup> *Ibid.*

<sup>1073</sup> Hardy, Quentin, “At Kodak, Clinging to a Future Beyond Film,” *The New York Times*, March 20, 2015.

<sup>1074</sup> *Ibid.*

<sup>1075</sup> Data from the U.S. Postal Service, “A Decade of Facts and Figures,” <http://about.usps.com/who-we-are/postal-facts/decade-of-facts-and-figures.htm>.

<sup>1076</sup> Data from the Newspapers Association of America.

<sup>1077</sup> Data from the Pew Research Center's 2015 “State of the News Media” report.

unpredictability of technological change, and the potentially disruptive effects on well-established businesses. So yes, containerization and fracking have given Panama's waterway a leg up in recent years. There is no reason, however, to believe in the future that all technological advances will benefit the Panama Canal.

Panama is also helpless to combat changes in the planet's climate that could profoundly impact the Panama Canal business model. The biggest threat is drought. The Panama Canal Authority fastidiously manages the canal watershed, through surveillance of deforestation and the use of water-saving technology in the new canal locks. Still, the canal authority does not control rainfall. That is a problem, given the waterway's thirst for water. Every ship that transits the canal requires 52 million gallons of freshwater from Gatun Lake, equal to the combined volume of 82 Olympic-sized swimming pools.<sup>1078</sup> In recent years, prolonged dry spells have significantly lowered the level of the lake, threatening the canal's viability as a shipping lane for large ships. As a result, in 2015, the canal authority temporarily prohibited transit by ships exceeding 39 feet of draft.<sup>1079</sup> Climate change will make extreme weather events more common. Scientists expect a greater frequency of El Niño occurrences, involving a warming of ocean sea surface temperatures that causes warmer temperatures and drier-than-average conditions in Panama. Over all, annual precipitation is expected to decrease in most of Central America, according to projections from the Intergovernmental Panel on Climate Change.

### **Internal Vulnerabilities**

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<sup>1078</sup> Spanne, Autumn, "Climate Change May 'Bottleneck' the Panama Canal and Disrupt World Trade," *The Guardian*, August 14, 2014.

<sup>1079</sup> A ship's draft is the number of feet that the hull of the ship extends beneath the surface of the water.

In the canal management categories that it controls, Panama has shined thus far, even if President Jimmy Carter is still waiting for his mea cuplas. (“It’s hard for politicians to admit that they were wrong,” Carter said.<sup>1080</sup>) Nevertheless, there are threats to the Panama Canal’s success that originate inside Panama’s borders and keep canal watchers up at night. These principally fall into two separate, but potentially interlinked, categories: (1) The potential rise of a Panamanian president who does not respect the canal’s autonomy; and (2) a severe economic crisis that leads Panamanian policymakers to raid the canal’s coffers, or to use its payroll as a dumping ground for the unemployed (Figure 1). Both scenarios are plausible. Panama does not permit consecutive presidential reelection, but its political system is still dominated by the executive branch. The Panamanian president serves a five year term, dominates the unicameral legislature and wields broad powers, including the right to decree a state of emergency and suspend constitutional guarantees. Given those prerogatives, the election of a populist authoritarian in Panama could jeopardize the Panama Canal’s indispensable autonomy. Even in Panama’s baseline scenario, corruption is rampant, as is patronage.<sup>1081</sup> “Presidents in this country are so powerful they can do a lot of damage,” Enrique E. Sánchez, the canal’s top procurement official, said. “Organizations like ours can be threatened if you get a Chávez.”<sup>1082</sup> Though the Panama Canal remains meritocratic, there were widespread fears that President Ricardo Martinelli would meddle in the selection in 2012 of a successor to longtime canal CEO Alberto Alemán. Ultimately, the

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<sup>1080</sup> Interview by author with Jimmy Carter, April 13, 2015.

<sup>1081</sup> In the World Economic Forum’s Global Competitiveness Report for 2016, Panama’s public institutions ranked 75th out of 140 countries, behind Swaziland (74th). Panama performed even more poorly in the corruption category, ranking 93rd, behind Kenya (92nd) and Russia (89th). In the diversion of public funds, Panama ranked 112th.

<sup>1082</sup> Interview by author with Enrique E. Sánchez, Panama City, Panama, August 5, 2013.



hiring process advanced independently, and the canal kept its strong reputation.

Panamanians, however, recall other moments when the canal appointment process did not meet expectations, such as in the late 1990s, when President Ernesto Pérez Balladares appointed four members of his family to the canal's governing board,<sup>1083</sup> alongside a handful of cronies.<sup>1084</sup> That troubling experience, shortly before the canal turnover, helps explain the concerns regarding Martinelli. "I was surprised myself," Quijano said of his appointment as Alemán's replacement, the first time a career canal official landed the top job. "I thought it would be more political."<sup>1085</sup> Martinelli "exposed a vulnerability," Gene Bigler, who served in U.S. Embassy in Panama City after the turnover, concluded.<sup>1086</sup>

A severe recession – especially if coupled with the election of a strongman – could also constrain canal autonomy. The Panama Canal has not faced either of these tests since its transfer to Panama. Since 2000, Panama has experienced 16 consecutive years of positive economic growth. In the last six years, GDP growth has not fallen below five percent. Still, Panama has many of the ingredients that often promote heavy handed, redistributive policies, and hyperpresidentialism. Poverty remains high; Panama ranked 60th on the United Nations Development Program's Human Development Index in 2014, below Belarus (50th), Kazakhstan (56th) and Bulgaria (59th).

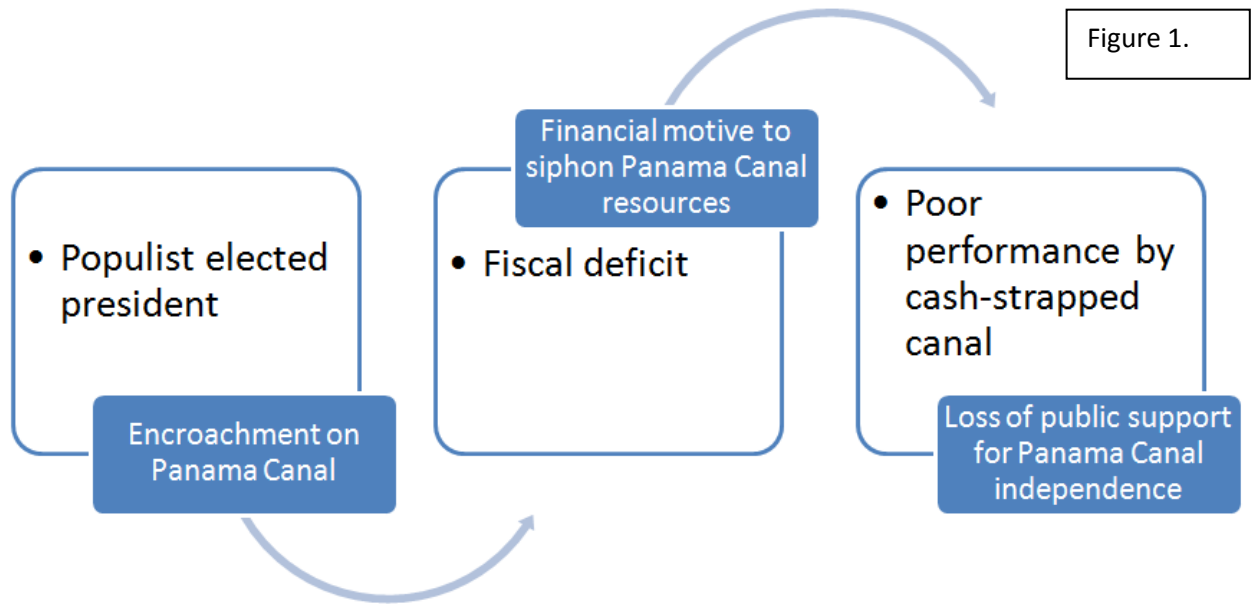
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<sup>1083</sup> Rohter, Larry, "Panama Leader Accused of Cronyism Over Appointees to Run the Canal," *The New York Times*, September 28, 1997.

<sup>1084</sup> Sánchez, Peter M., *Panama Lost? U.S. Hegemony, Democracy and the Canal* (Gainesville, Fla.: University Press of Florida, 2007), p. 182.

<sup>1085</sup> Interview by author with Jorge L. Quijano, Washington, D.C., May 20, 2015.

<sup>1086</sup> Interview by author with Gene Bigler, May 11, 2015.



Despite increasing per capita income – \$19,455 in 2014, the highest in Central America – life expectancy in Panama is only 77 years old, compared to 80 in the United States.<sup>1087</sup>

The poverty rate is particularly egregious in rural areas, home to the most disadvantaged Panamanians, including indigenous communities where sanitation is limited. Panama is one of the world's most unequal countries. The richest 20 percent of Panamanians hoard 56 percent of all income.<sup>1088</sup> Panama's Gini coefficient of 51.7<sup>1089</sup> puts Panama in the top 20 globally, worse than Swaziland (50.4) and Papua New Guinea (50.9).<sup>1090</sup> In these conditions, it is not hard to imagine a populist president questioning whether the Panama Canal Authority should retain \$11.2 billion in reserves<sup>1091</sup> while 3 percent of the

<sup>1087</sup> Panama life expectancy data from the World Health Organization.

<sup>1088</sup> Data from the World Bank for 2013.

<sup>1089</sup> Ibid. By comparison, the Gini coefficient in the United States is 47.6, and 31.3 in Canada.

<sup>1090</sup> Gini coefficient comparisons from the CIA World Fact Book. The higher the Gini coefficient, the more unequal the income distribution. If income were distributed equality, the coefficient would be zero; if income were distributed with perfect inequality, the coefficient would be 100.

<sup>1091</sup> Reserves data from the Panama Canal Authority 2014 annual report. The reserves include \$2.8 billion in current assets, such as cash, and \$8.4 billion in fixed assets, including property and equipment.

population lives on \$1.90 a day.<sup>1092</sup> “You look at the balance sheet of the canal and what do you see? Cash,” Ricaurte Vásquez, the former deputy administrator of the canal, said.<sup>1093</sup> In normal times, even a populist leader of Panama would be unlikely to pressure the canal authority to auction off its dredges, towboats, floating cranes and launches to cushion government accounts. Deep fiscal troubles, however, could put severe pressure on canal independence.

Panama might be headed in that direction. Lately, Panamanian officials have loosened the purse strings, with the 2016 fiscal deficit estimated at 1.2 percent of GDP. Public sector debt has increased from 43 percent of GDP in 2012 to an estimated 47 percent in 2015,<sup>1094</sup> the result of extravagant infrastructure spending. In times of growth – GDP increased by 8.5 percent in 2014 – that level of public spending is arguably sustainable. But on a rainy day, Panamanian budget writers might begin to question the Panama Canal Authority’s significant reinvestment of profits. In 2014, for example, the canal board set aside nearly \$300 million of the \$1.325 billion net profits. (Even in Panama’s fat-cow years, there is grumbling about the size of the canal dividend.<sup>1095</sup>) “They’re not a hermetically sealed entity that no one in the government is paying attention to,” Christopher L. Koch, president of the World Shipping Council, said.<sup>1096</sup> For that reason, canal officials often express interest in the national economy, and look for linkages to other sectors. The canal authority coordinates closely with the National Competitiveness Center, run by former President Nicolás Ardito Barletta.<sup>1097</sup> There is

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<sup>1092</sup> Ibid. The trend for Panama is impressive; in 1991, 22 percent of the population was impoverished, compared to 3 percent in 2013.

<sup>1093</sup> Interview by author with Ricaurte Vásquez, August 2, 2013, Panama City, Panama.

<sup>1094</sup> International Monetary Fund’s Regional Economic Outlook, April 2015.

<sup>1095</sup> Interview by author with Guillermo O. Chapman Jr., Panama City, Panama, August 28, 2013.

<sup>1096</sup> Interview by author with Christopher L. Koch, September 5, 2014.

<sup>1097</sup> Interview by author with Luis Alberto Morán, August 7, 2013, Panama City, Panama.

great promise. Eighty percent of container vessels that transit the canal stop at a port to drop off or pick up cargo – an important transshipment business for Panama. “I’m not just pushing the canal, I’m pushing Panama,” Quijano said in a speech in Washington in 2015. At the end of the day, however, the canal cannot shield Panama from the business cycle or control global trade, any more than it can make it rain over Lake Gatun. Nor does the canal control other public institutions in Panama, despite expectations that its example might professionalize, and clean up, the rest of the Panamanian government. There are some spillovers; Panama’s Ministry of Education, for example, has adopted the canal authority’s contracting regulations, which Panamanian authorities also used for its first subway.<sup>1098</sup> In general, however, many in Panama fear the influence could go in the other direction. “I don’t believe in islands of excellence,” Vásquez, the canal’s former deputy administrator, said.<sup>1099</sup>

## **Image Problem**

The Panama Canal Authority also has an image problem that could jeopardize its operations in tougher times. Outside Panama, the canal authority is widely respected in the maritime industry, as demonstrated by private surveys.<sup>1100</sup> The canal authority’s official Customer Satisfaction Index hit 98.5 percent in the 2014 fiscal year.<sup>1101</sup> Inside Panama, the canal itself is an unalloyed emblem of Panamanians nationhood. Panama Canal Zone independence is modern Panama’s proudest accomplishment. The

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<sup>1098</sup> Omar Jaén Suárez, *Diez Años de Administración Panameña del Canal* (Panama City, Panama: Panama Canal Authority, 2010), p. 245.

<sup>1099</sup> Interview by author with Ricaurte Vásquez, August 2, 2013, Panama City, Panama.

<sup>1100</sup> See Chapter 3 for results of a survey by the author of members of the World Shipping Council and the American Maritime Congress regarding their perceptions of the Panama Canal Authority.

<sup>1101</sup> Panama Canal Authority, Annual Report, 2014. To further satisfy customers, the authority presented commemorative plaques for the canal’s 100th anniversary to vessels that reached 100 transits, and to vessels that transited on the anniversary, August 15, 2014.

independence of the Panama Canal Authority, on the other hand, tends to irritate Panamanians. Former Panamanian strongman Omar Torrijos foresaw this problem after he signed the Carter-Torrijos treaties. In a speech, he acknowledged fears that Panama would “recover this expanse of land merely to change owners, to change a blond master for a dark master.” To critics, the administrative policies and cultural norms lovingly preserved from the U.S. canal era are a colonial hangover, and the authority’s autonomy from Panama’s elected leaders is undemocratic. Surveys suggest Panamanians feel distant from the canal.<sup>1102</sup> In 2002, one Panamanian critic, Virgilio Araúz, published a book lambasting the Panama Canal Authority for behaving like a “government within a government.”<sup>1103</sup> In his cri de coeur, “The Fight for Sovereignty and the Policies of the Panama Canal Authority,” he criticized the canal authority for siphoning resources from Panama to reinvest in the canal,<sup>1104</sup> and he called for the canal’s finances to be incorporated into the national budget. “Our fight is not over,”<sup>1105</sup> he said. Many Panamanians bemoan the elitist attitudes of canal executives. They also grumble about the persistent exclusivity of the former Panama Canal Zone, where gated communities, hot stone massages at the Gamboa Rainforest Resort and the Victoria Secret outlet at the upscale Albrook Mall draw wealthy foreigners and price out working class locals. “A few Panamanian intellectuals and leftists dislike the autonomy,” Roberto Roy, chairman of the Panama Canal Authority’s Board of Directors, acknowledged. “They say this is another canal zone.”<sup>1106</sup>

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<sup>1102</sup> Suárez 2010, p. 216.

<sup>1103</sup> Virgilio Araúz, *La Lucha por la Soberanía y la Política Actual de la Autoridad del Canal de Panamá* (Panama City, Panama: Ediciones Propuesta, 2002), p. 58.

<sup>1104</sup> Ibid., p. 131.

<sup>1105</sup> Ibid., p. 135.

<sup>1106</sup> Interview by author with Roberto Roy, Panama City, Panama, August 26, 2013.

Panama Canal Authority executives understand that their operational independence depends not only on constitutional prerogatives and solid financial performance, but also on the willingness of Panamanians to give them plenty of breathing room. For that reason, as discussed, the canal budget supports a constellation of outreach programs, including literal bridge building in Colón, where canal authority volunteers also rehabilitate schools and clean up beaches. Like a U.S. defense contractor sourcing airplane parts in every congressional district, the Panama Canal Authority boasts of employees from even distant provinces.<sup>1107</sup> These investments in corporate social responsibility, however, have failed to make the canal relatable.<sup>1108</sup> Despite its consistent and impressive financial performance, the Panama Canal Authority is not particularly popular. Vanderbilt University, in Nashville, Tenn., has been biannually surveying Panamanians about the Panama Canal Authority since 2008.<sup>1109</sup> In each survey, respondents are asked to rate their confidence in the canal authority on a scale of 1 to 7. The results are not encouraging. The mean response has never exceed 5.2, and it has fallen in each of the past two surveys.<sup>1110</sup> The canal authority is also struggling to differentiate itself from other public institutions and businesses in Panama. Under Aléman, canal officials used to invite survivors of the January 9, 1964 canal riots to visit the waterway and discuss their role in the canal's history. Today, those stories resonate

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<sup>1107</sup> That includes Comarca Emberá-Wounaan, an indigenous community in the Darién province, by the Colombian border, where the Pan-American Highway is interrupted by tropical rainforest and Frommers lures adventurous tourists with the promise of “run-ins with terrorist groups.”

<sup>1108</sup> In fairness, the canal has never had an everyman quality. In July 1989, for example, the Board of Directors of the U.S.-led Panama Canal Commission celebrated the canal's 60th anniversary with a gala at the elegant Cliff House Restaurant in Washington State, on a bluff overlooking Commencement Bay that offers diners panoramic views of Mount Rainier and Puget Sound. The menu included a “two-ocean” salad, “control house clam chowder,” “Galliard Cut filet mignon,” “Miraflores Spillway king salmon” and “Bridge of the Americas” chicken breasts, paired with “fast transit spirits.”

<sup>1109</sup> The survey is conducted by Vanderbilt's Latin American Public Opinion Project, known as LAPOP.

<sup>1110</sup> The following are the mean responses in the five LAPOP surveys that have asked respondents to evaluate the management of the Panama Canal on a 1-7 scale: 2006: 3.95; 2008: 4.34; 2010: 5.19; 2012: 5.14; 2014: 4.60. Means calculated by author in STATA.

less and less. Eighty-four percent of Panamanians were either not born at the time of the riots, or were less than two year old.

Panama's youthful demographics have significant implications for the attitudes and morale of canal employees. There are fewer and fewer canal workers whose professional commitment and motivation are fueled by personal memories of the country's struggle to recover the Panama Canal Zone. At the same time, there are fewer and fewer canal employees who were mentored by U.S. canal officials. Taken together, some observers say, that has made the average canal worker less dedicated and arguably less technically prepared. Eventually, the canal "is going to be like any other government institution, full of bureaucrats and political appointees," Fernando Cardoze, who served twice on the Panama Canal Commission's Board of Directors, said.<sup>1111</sup> There are signs that such a transition is already underway. Historically, every Panamanian mother dreamed of landing her child a job at the canal. Those lucky enough to work at the waterway felt intimately linked to the operation. Enrique E. Sánchez, the head of canal procurement, is a telling example. Sánchez is a third generation canal employee: his Jamaican-born grandparents worked at the canal, with his mother's father hired as a canal laborer and his father's father working as a carpenter at the canal railroad. His own father was a technician for water meters in the former Panama Canal Zone. These days, a worker's connection to the canal does not always last a career, let alone span generations in one family. As Panama's economy has grown and diversified, the private sector has begun luring away the next generation of canal leaders. In 2013, for example, two heavy machinery operators resigned, the first time in recent memory that employees at that level

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<sup>1111</sup> Interview by author with Fernando Cardoze, Panama City, Panama, August 14, 2013.

had ditched the canal for another job.<sup>1112</sup> Recruitment is also a growing challenge. The authority hires 50 new employees every year, and it has increasingly found itself going head-to-head with multinational companies that operate their regional headquarters in Panama City. “The canal is not necessarily the first option anymore,” Francisco Loaiza, the canal’s top human resources official, said.<sup>1113</sup> To improve recruitment, retention and the canal’s esprit de corps, Loaiza set up a professional development program titled, “Identidad Canalera,” which attempts to differentiate the canal experience from a job at, say, General Electric or Google. The effort is critical, as young Panamanians often have little appreciation for the canal’s traditional special status in Panamanian society. “The new generation sees the canal as just another business,” Loaiza said, not as the “the product of a generational battle.”<sup>1114</sup>

A survey in September 2015 revealed more fundamental troubles with the canal’s public profile in Panama.<sup>1115</sup> Prior to the canal turnover, 49 percent of Panamanians expected Panama to manage the canal somewhat or very efficiently.<sup>1116</sup> Today, 15 years, 224,424 transits<sup>1117</sup> and billions of dollars in revenue later, the perception of canal performance has barely budged (Figure 2).<sup>1118</sup>

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<sup>1112</sup> Interview by author with Rogelio Gordón, Panama City, Panama, August 29, 2013.

<sup>1113</sup> Interview by author with Francisco Loaiza, Panama City, Panama, August 13, 2013.

<sup>1114</sup> Loaiza’s canal cohort has no such challenge. Like other canal lifers, he speaks referentially about the canal as a kind of patriotic priesthood. “We have a responsibility to our children and grandchildren and great grandchildren,” he said. “Every generation that is here working has to make sure that the canal is ready for the next generation.”

<sup>1115</sup> The survey of 1,228 respondents, designed by the author, was carried out by CID-Gallup September 4-11, 2015. It covered the entire Panamanian territory, and included a randomized and representative sample of adults (aged 18 or older). Sample margin of error:  $\pm 2.8$  points.

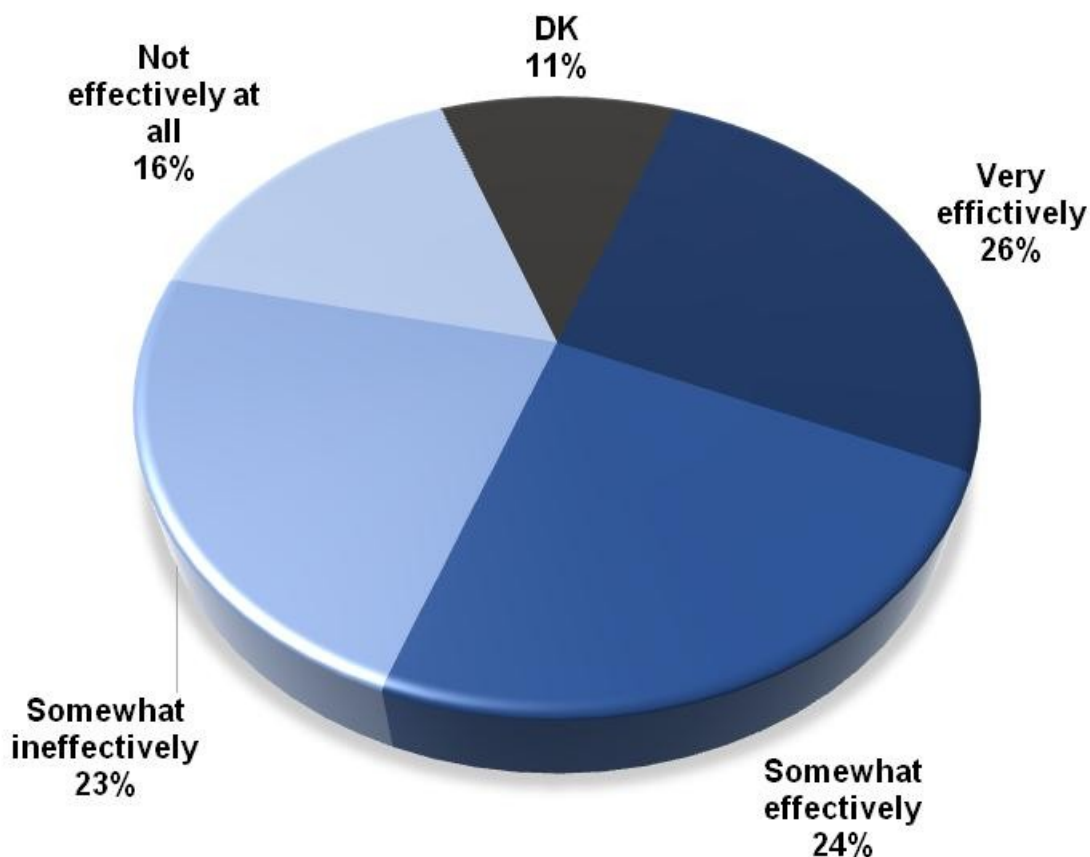
<sup>1116</sup> “Thinking back to when the canal was given to the Panamanians, how well did you expect the Panamanians to operate the canal?”

<sup>1117</sup> Calculation by author based upon data in Panama Canal Authority annual reports, including the portion of the 1999 fiscal year prior to the turnover.

<sup>1118</sup> “In your opinion, how well do you think the Panama Canal Authority is running the canal now?”



Figure 2.  
Perception of  
canal efficiency

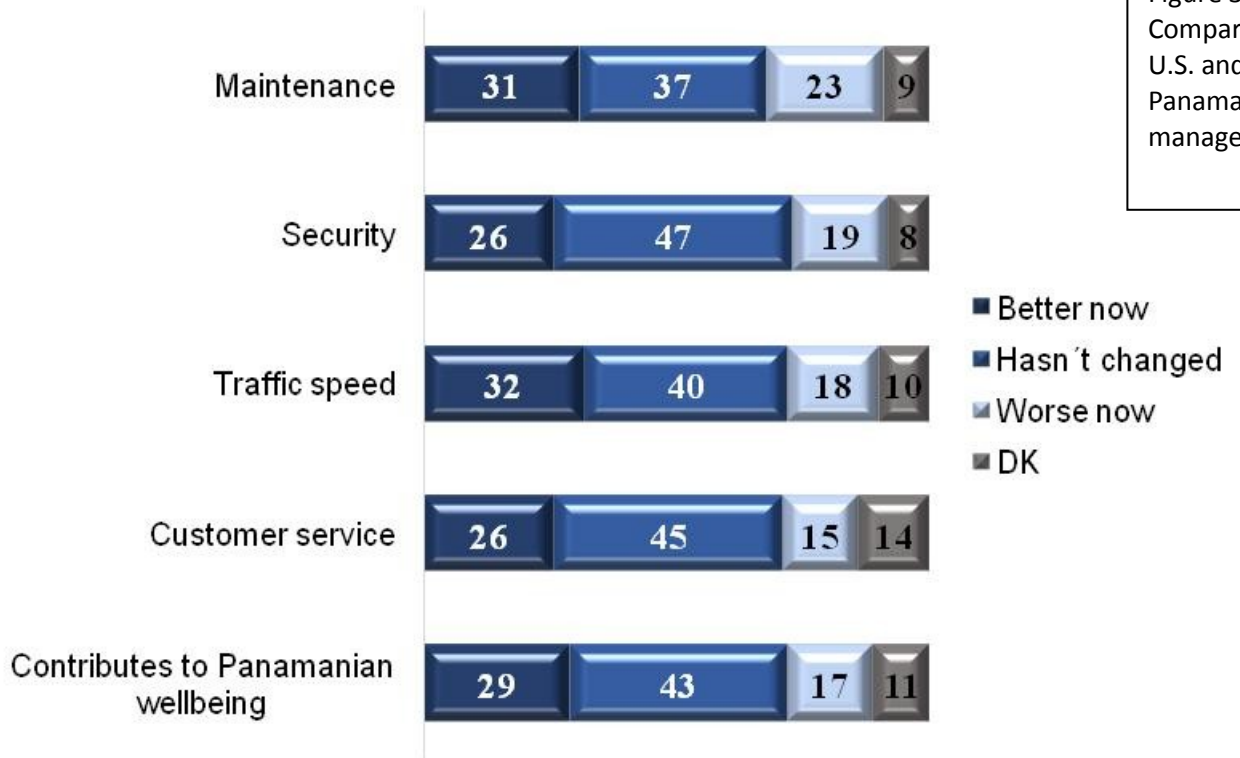


In all administrative categories, the number of respondents who say the quality of canal management has remained the same always exceeds the number who see improvement (Figure 3).<sup>1119</sup>

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<sup>1119</sup> “Considering the following categories, how would you compare the management of the canal today to the management of the canal when the United States owned it?”

Figure 3.  
Comparisons of  
U.S. and  
Panamanian canal  
management



For example, nearly a quarter of respondents (23 percent) say maintenance is *worse* under Panamanian management. In terms of customer service, the Panama Canal Authority's supposed specialty, 60 percent of respondents see a deterioration or no improvement, though it is not clear how respondents are judging that category. Most worrisome of all, less than a third of Panamanians (29 percent) say the canal contributes more to Panamanian wellbeing under Panamanian ownership than under U.S. control. Perhaps that is not the relevant comparison; there is no plausible scenario involving a return of the canal to the United States. Arguably, it would be sufficient if the average Panamanian shared the elite opinion that the Panama Canal Authority is immeasurably superior to other *Panamanian* institutions. That way, Panamanian society would be more likely to continue discouraging any political intervention in canal management. Here, too,

however, the survey gives cause for concern. Only 21 percent of Panamanians say the Panama Canal Authority is better than Panama's executive branch (Figure 4).

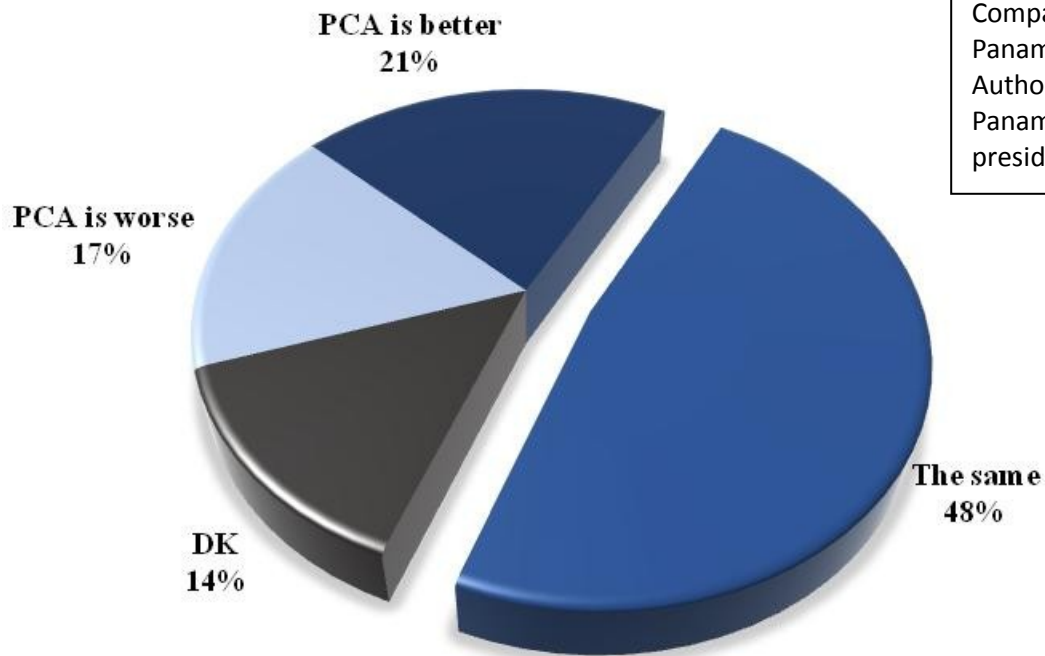
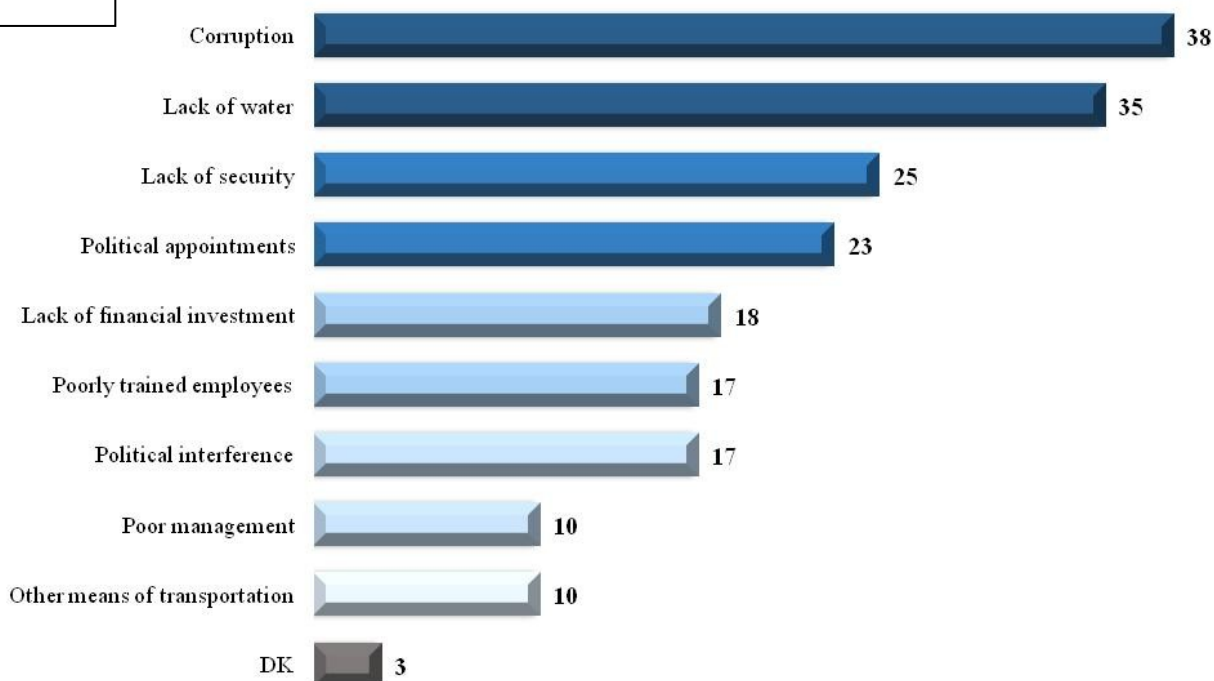


Figure 4.  
Comparison of  
Panama Canal  
Authority and  
Panamanian  
presidency

The contrast between the canal authority's self image and the public perception is stark. The canal authority projects incorruptibility, bolstered by an independent and crusading inspector general. Still, 38 percent of Panamanians see corruption as the greatest challenge facing the canal (Figure 5).<sup>1120</sup>

<sup>1120</sup> "Which of the following would you consider the two greatest challenges in operating the Panama Canal: corruption, lack of water, lack of security, political appointments, lack of financial investment, poorly trained employees, political interference, poor management, or other means of transportation?"

Figure 5. Greatest challenges facing the canal



The survey results were not entirely grave, however. The Panamanians with arguably the most political influence – the most urban and the most educated – have a higher than average opinion of the canal authority. For example, 32 percent of college educated Panamanians say the canal contributes more to Panamanian society now than it did in the U.S. era, compared to 27 percent of those without a high school education. Similarly, 28 percent of college educated Panamanians consider the canal authority superior to the executive branch, compared to 18 percent of the least educated respondents.

The Panama Canal Authority still enjoys significant constitutional and legal protections. It has elite backing. It has earned international admiration, and could rely upon the implicit support of multinational shippers and sympathetic governments in any conflict with the political branches of the Panamanian government. Still, if canal officials thought they were protected by a bulwark of favorable public opinion, they should think again.

## **Case Study Disease**

A final threat to the canal's future is vague and paradoxical, but still worth mentioning. To cynics, the very fact of Panama's success running the canal is foreboding. Why? Because today's case studies are tomorrow's cautionary tales. This is a fairly universal phenomenon, but what might be called the "case study disease" appears especially common with state-owned enterprises. The reason is not clear. Perhaps observers are so excited to find a rare example of successful state-owned enterprise management that they ignore the vulnerabilities. Or maybe it is that state-owned enterprises are human constructs, and therefore inherently imperfect. Either way, the long history of case studies gone wrong is enough to induce a panic attack when considering the seemingly bright future of the Panama Canal.

Examples of chronically mismanaged state-owned enterprises are legion, as discussed. The most recent example is in Puerto Rico, where irresponsible state-owned enterprises have helped push the island toward financial ruin. (The Puerto Rican power authority notoriously accumulated \$9 billion in debt by providing free power to Puerto Rico's 78 municipalities, many other state-owned enterprises and to a handful of private businesses.) However, there are also worrisome instances of state-owned enterprises that have thrived, and then fallen from grace. Brazil offers two compelling examples: Petroleo Brasileiro, known as Petrobrás, and the Brazilian Development Bank, known as BNDES. For decades, Petrobrás was the pride of Brazil. The integrated energy company handled exploration and production, refining, distribution, dabbled in petrochemicals and worked in conventional and shale oil and gas, as well as ethanol. Its size, track record, operational

independence, and 49 percent ownership by private investors challenged the notion that a state-owned enterprise could not go toe-to-toe with private sector competitors. Today, Petrobrás is shorthand for government corruption. In 2014, a massive Petrobrás scandal came to light that has destabilized Brazilian politics, deepened a recession, left thousands of Brazilians out of a job and “all but devastated Brazil’s status as an up-and-comer on the world stage.”<sup>1121</sup> Beginning in 2014, investigators have learned, Petrobrás executives began soliciting bribes – including cash, Rolexes, \$3,000 bottles of wine, yachts, helicopters and prostitutes – in return for letting companies overcharge Petrobrás for a range of services, such as maintaining an oil rig or building a refinery. In all, the kickbacks totaled \$3 billion – bribes that Petrobrás executives split with members of the ruling Workers Party, which allegedly pocketed \$200 million through the “Operation Carwash” scheme. During part of that period, Brazilian President Dilma Rousseff served as the Petrobrás chairman. As a result of the scandal, 117 Brazilian individuals and 13 companies face criminal charges; prosecutors have arrested five Brazilian politicians; and Petrobrás, once the sixth-largest company in the world, has lost \$70 billion, about half its pre-scandal value. The value of Petrobrás shares has plummeted from \$72.38 on May 23, 2008 to \$3.03 on January 22, 2016. In November 2015, Petrobrás Chairman Murilo Ferreira resigned, disrupting the company’s desperate attempts to sell \$57 billion in assets by the end of 2017.<sup>1122</sup>

As with Petrobrás, the Brazilian government used to get kudos for its management of BNDES, the massive development bank. As recently as 2013, Johns Hopkins University researcher Seth Colby highlighted BNDES’s role in Brazil’s

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<sup>1121</sup> Segal, David, “Petrobras Oil Scandal Leaves Brazilians Lamenting a Lost Dream,” *The New York Times*, August 7, 2015.

<sup>1122</sup> Horchnov, Dan, “Petrobras Chairman Steps Down,” *The New York Times*, November 30, 2015.

economic development, and declared it free of the rent-seeking and corruption that plague so many state-owned financial institutions globally.<sup>1123</sup> Colby acknowledged that BNDES had critics. For example, in a 2012 paper, Mansueto Almeida and Ben Ross Schneider argued that BNDES primarily subsidized so-called national champions, an approach similar to the policies that contributed to the 1980s Latin America debt crisis. In particular, the authors criticized BNDES for locking Brazil into its position as an economy specializing in commodities and low-tech exports. Today, as Brazil struggles to overcome a deepening recession, BNDES has come under even greater scrutiny. BNDES does not face the accusations of corruption that dog Petrobrás. However, its critics, including the Organization for Economic Cooperation and Development, say BNDES's size and subsidized interest rates are crowding out private loans: BNDES is the largest development lender in Latin America, with outstanding loans equal to 6 percent of Brazil's gross domestic product<sup>1124</sup> and a pace of lending that far outstrips the World Bank.<sup>1125</sup> The subsidies – Brazil has shoveled \$138 billion into BNDES – have permitted BNDES to dominate the country's financial sector, controlling a quarter of outstanding loans. Other critiques call on BNDES to pay more attention to infrastructure projects and small and medium-sized enterprises. For now, critics say, four-fifths of BNDES lending goes to large companies, such as Marfrig, the food processing giant and, of course, Petrobrás. Public spending on BNDES now exceeds the cost of Bolsa Família, Brazil's

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<sup>1123</sup> Colby, Seth, "Searching For Institutional Solutions to Industrial Policy Challenges: A Case Study of the Brazilian Development Bank," dissertation, Johns Hopkins University, 2013.

<sup>1124</sup> Boadle, Anthony, "Brazil's BNDES Crowding Out Private Banks from Loans, OECD Says," *Reuters*, October 22, 2013.

<sup>1125</sup> "Nest Egg or Serpent's Egg?," *The Economist*, August 5, 2010.

mega monthly cash transfer program. That milestone, and BNDES's lending style, have given BNDES the nickname "Bolsa Empresário, or "Tycoon Grant."<sup>1126</sup>

## Conclusion

Can Panama avoid the fate of the once-admired Venezuelan or Brazilian oil companies? Can it sustain its success in the face of drought, competition from the Northern Sea Route, an expanding Suez Canal<sup>1127</sup> and a possible Grand Nicaragua Canal? Can it survive an economic downturn in Panama, and the election of a populist hell-bent on stripping the canal of its independence, and dipping into its bank accounts? It is impossible to say. As Juan Sosa, Panama's former U.S. ambassador, wrote in his memoir, "only time will tell."<sup>1128</sup>

Panama's failure, however, is hardly inevitable. Not all state-owned enterprises stumble. As Mariana Mazzucato writes in "The Entrepreneurial State," the popular view of national governments as "bureaucratic, inertial, heavy-handed" is a crude stereotype.<sup>1129</sup> So far, at the Panama Canal, the evidence of state capacity is impressive. Opponents of the Carter-Torrijos treaties had portrayed Panamanians as "subhumans," dedicated to the narcotics trade and too incompetent to operate the canal, President Jimmy Carter wrote in his diary during the treaty negotiations.<sup>1130</sup> In fact, the canal business has been strong since the first day after the turnover, 16 years ago. Toll revenue

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<sup>1126</sup> Leahy, Joe, "BNDES: Lender of First Resort for Brazil's Tycoons," *The Financial Times*, January 11, 2015.

<sup>1127</sup> Egyptian President Abdel Fattah al-Sisi reportedly spent \$4 billion to build a second Suez canal parallel to the existing waterway, a shortcut from the Mediterranean to the Red Sea. It opened in August 2015. As a sea-level canal, Suez has a natural advantage over Panama, where the locks impose size limits on vessels. The transit through Suez, however, is slower than the passage through the Panama Canal.

<sup>1128</sup> Juan B. Sosa, *In Defiance* (Washington, D.C.: The Francis Press, 1999), p. 282.

<sup>1129</sup> Mariana Mazzucato, *The Entrepreneurial State: Debunking Public Vs. Private Sector Myths* (London, United Kingdom: Anthem Press, 2013).

<sup>1130</sup> Jimmy Carter, *White House Diary* (New York City, N.Y.: Farrar, Straus and Giroux, 2010), p. 81.



in the 2014 fiscal year amounted to \$1.9 billion, compared to \$769 million in 2000. Despite repeated and sizable toll hikes, alternative routes have not lured away canal customers. The Panama Canal's "value is unquestioned, and its value in the future will be every bit as important as it was in the past," James E. Caponiti, president of the American Maritime Congress, said.<sup>1131</sup> The data for canal transits and tonnage is astounding, even as Panama's performance fluctuates with global economic trends. As discussed, accidents are down, transit speed is respectable and customers are thrilled. There has been no hint of corruption or patronage, even as the Panama Canal Authority undertook a \$5.25 billion expansion project. Unlike most state-owned enterprises – like state-owned railroads in the United Kingdom or most public utilities – the Panamanian public does not pressure the canal to keep prices low, since few Panamanians are canal customers. As long as Panamanians keep seeing the dividends flowing, the canal gets to go about its business. "They feed the bear," Richard Morgan, a former senior U.S. canal official said. "If they keep on paying that to the government, the government is unlikely to mess with them."<sup>1132</sup> The Panamanian public, in a 2006 referendum, expressed its confidence in canal management by authorizing the costly expansion. In 2012, the canal authorities appointed a new administrator without any apparent political intervention, cronyism or favoritism. Politicization "is always a risk," Manuel E. Benítez, the deputy canal administrator, said.<sup>1133</sup> But it is unlikely, he said: "Putting that at risk puts at risk the image of the country." So while the canal's future is uncertain, the baseline scenario is continued professionalism and financial success.

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<sup>1131</sup> Interview by author with James E. Caponiti, December 2, 2014.

<sup>1132</sup> Interview by author with Richard Morgan, May 11, 2015.

<sup>1133</sup> Interview by author with Manuel E. Benítez, Panama City, Panama, August 5, 2013.

Given the mixed track record of most state-owned enterprises, Panama's success is unlikely the result of dumb luck. Rather, Panama's unique approach to structuring and managing the Panama deserves considerable credit, as do the public, elite and government commitments to preserving that successful model. As discussed at length, the foundation of the Panamanian model was the determined effort to build a national consensus about the canal's structure and future management. In the years after the devastating 1989 U.S. invasion, Panama, with help from the United Nations, held national dialogues on the future of the canal that spread responsibility for the waterway to all sectors of Panamanian society. Suddenly, the canal had millions of guardians, and anyone who wished it harm expected sharp public disapproval.

The canal's institutional framework is similarly unique and estimable. Both the Panama Canal's constitutional foundation, approved in 1995, and the 1997 canal legislation represented an astonishing delegation of power by the Panamanian presidency and legislature. The Panama Canal Authority, as a result, is truly an autonomous legal entity. The Panamanian president can unilaterally appoint only one member of the canal's 11-member governing board. Board members serve staggered, nine-year terms. The board is invested with quasi-legislative authority, including the right to set tolls. Canal employees are subject to a special, merit-based labor regime, and prohibited from striking. The canal is financially independent, and *required* to turn a profit. It is prohibited from buying government debt, or from guaranteeing government obligations. Taken together, this institutional design and the societal consensus that sustains have turned Panama into an unlikely case study in successful state-owned enterprise management. These advantages will not make it rain in Panama, stop Nicaragua from

building a rival waterway, or keep the Trans-Pacific Partnership or melting Arctic ice from diverting trade. However, it seems clear that “if the Panama Canal declines in the future, it will be because of shifts in the global economy,” and “not because of a Panamanian inability to run the Panama Canal.”<sup>1134</sup> Walter Bottin, who worked for the canal from 1963 to 2000 and still lives in the former Panama Canal Zone, puts it plainly: “If they were going to screw it up, they’d have screwed it up already.”

At the canal, screw ups are rare nowadays. The Panamanians make it look easy. The Panamanian flagged NYK Meteor, a full container ship traveling between Shanghai and New York,<sup>1135</sup> regularly transits the canal carrying 4,067 containers. It is gigantic; at 965 feet long, with a beam (width) of 106 feet, the NYK Meteor barely fits inside the canal’s 1,000 feet long, 110-foot wide locks. Its transit require help from 22 linehandlers and eight locomotives. Nevertheless, the NYK Meteor’s shortcut across Panama is routine, and borderline mundane. In a recent transit, the vessel made a predawn approach to the canal’s Pacific entrance, with lighting and the Panama City skyline visible in the distance. In the pitch black, choppy Pacific waters, a launch approached to drop off a Panama Canal Authority pilot, who climbed a ladder to board the container ship and take command of the bridge from the captain, helmsman and third mate. Nearby, a car carrier edged into the canal channel, as a Maersk post-Panamax vessel at the Balboa port unloaded cargo for a transit aboard the Panama Canal Railroad. Meanwhile, on the NYK Meteor, a boarding officer took measurements, found everything in good order and authorized the passage. “I wish you well,” he said and moments later, at 4:29 a.m., the

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<sup>1134</sup> Noel Maurer and Carlos Yu, *The Big Ditch: How America Took, Built, Ran and Ultimately Gave Away the Panama Canal* (Princeton, N.J.: Princeton University Press, 2010), p. 331.

<sup>1135</sup> The NYK Meteor makes stops in Busan, Qingdao, Ningbo, Shanghai, the Panama Canal and New York.

canal pilot called for “dead slow ahead” and the transit began. From that point on, the hours passed slowly and with little drama. In addition to the linehandlers and locomotives, the journey was made possible by help from the tug boats Bocas del Toro and D. P. McAuliffe, and two additional canal pilots who boarded the vessel as it entered the Miraflores locks. The NYK Line got what it paid for, a \$390,086 eventless trip to the Atlantic Ocean.

As with any case study, it would be risky to suggest that Panama’s experience is universally applicable. Process tracing is useful, but the reach of its conclusions is always limited. The steps Panama pursued in the former Panama Canal Zone are not an exportable roadmap for China’s struggling state-owned banks or Nigeria’s state-owned oil company. It would take a very different research approach – perhaps randomly assigning several similar countries to dig canals – to control for all the variables that led to Panama’s success. The Panama case study is even more idiosyncratic than most; Panama’s premier state-owned enterprise inherited from the United States its infrastructure and long-established corporate norms and management structures. “This institution had a long, good tradition,” Roy, the chairman of the Panama Canal Authority’s Board of Directors, said. “We’re not talking about something that came out of thin air.”<sup>1136</sup>

Moreover, the basics of effective state-owned enterprises management are not a complete mystery. In 2005, the Organization of Economic Cooperation and Development put out its first edition of its “Guidelines on Corporate Governance of State-Owned

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<sup>1136</sup> Interview by author with Roberto Roy, Panama City, Panama, August 26, 2013.

Enterprises.”<sup>1137</sup> The effort recognized that in many countries, particularly emerging markets, state-owned enterprises are the principle providers of public services, such as utilities, energy, transportation and telecommunications. Given this central economic role, the guidelines emphasize the importance of addressing the many struggles of state-owned enterprises, which range from excessive and politically motivated government intervention to excessive government neglect. To address these and other challenges, the 2015 guidelines for helping state-owned enterprises increase efficiency, transparency and accountability include disclosure of clear corporate objectives and encouragement of private sector competition.

Despite the idiosyncrasies of Panama Canal history and the established best practices in state-owned enterprise management, Panama might still have something to offer policymakers struggling with state-owned enterprise design and to technical experts at the International Monetary Fund and multilateral development banks who struggle with the consequences of state-owned enterprise mismanagement. Even the statist Cuban regime is now open to experimentation with its state-owned enterprises; in 2014, Cuban authorities authorized state-owned enterprises to retain up to 50 percent of their profits.<sup>1138</sup> In the near future, it is highly probable that a new Venezuelan government will come along and attempt a rebirth of PDVSA. For that and similar reorganizations, Panama offers a strong counterpoint to critics who insist governments simply can never succeed in running a business. In direct contrast to the “case study disease” predictions,

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<sup>1137</sup> The 2015 edition of the guidelines is available through the online OECD iLibrary, [http://www.oecd-ilibrary.org/governance/oecd-guidelines-on-corporate-governance-of-state-owned-enterprises-2015\\_9789264244160-en](http://www.oecd-ilibrary.org/governance/oecd-guidelines-on-corporate-governance-of-state-owned-enterprises-2015_9789264244160-en).

<sup>1138</sup> “Cuba Gives State-Run Companies,” *Associated Press*, April 28, 2014.

Panama's triumph appears to be self-perpetuating. "The best protection for the canal," says Samuel Lewis Navarro, the former Panamanian vice president, "is its success."<sup>1139</sup>

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<sup>1139</sup> Interview by author with Samuel Lewis Navarro, Panama City, Panama, August 21, 2013.

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